S. HRG. 107–1130

S. 415, AVIATION COMPETITION RESTORATION ACT

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

MARCH 13, 2001

Printed for the use of the Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE

88–037 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

JOHN McCAIN, Arizona, *Chairman*

TED STEVENS, Alaska
CONRAD BURNS, Montana
TRENT LOTT, Mississippi
KAY BAILEY HUTCHISON, Texas
OLYMPIA J. SNOWE, Maine
SAM BROWNBACK, Kansas
GORDON SMITH, Oregon
PETER G. FITZGERALD, Illinois
JOHN ENSIGN, Nevada
GEORGE ALLEN, Virginia

ERNEST F. HOLLINGS, South Carolina
DANIEL K. INOUYE, Hawaii
JOHN D. ROCKEFELLER IV, West Virginia
JOHN F. KERRY, Massachusetts
JOHN B. BREAUX, Louisiana
BYRON L. DORGAN, North Dakota
RON WYDEN, Oregon
MAX CLELAND, Georgia
BARBARA BOXER, California
JOHN EDWARDS, North Carolina
JEAN CARNAHAN, Missouri

MARK BUSE, *Republican Staff Director*
ANN CHOINIERE, *Republican General Counsel*
KEVIN D. KAYES, *Democratic Staff Director*
MOSES BOYD, *Democratic Chief Counsel*

CONTENTS

WITNESSES

S. 415, AVIATION COMPETITION RESTORATION ACT

TUESDAY, MARCH 13, 2001

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Committee met, pursuant to notice, at 9:30 a.m. in room SR–253, Russell Senate Office Building, Hon. John McCain, Chairman of the Committee, presiding.

OPENING STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

The CHAIRMAN. Today, the Committee will hear testimony on S. 415, the Aviation Competition Restoration Act. S. 415 was introduced by our distinguished ranking member, Senator Hollings. I was one of the original cosponsors of this bill, and we worked together on this issue to attempt to craft legislation that would effectively address some of the shortcomings in our aviation system today.

The airline industry is in turmoil. There are numerous reasons for these problems which can be lumped into four major categories: mergers, competition, delays, and capacity. I would add one other issue, Senator Hollings, and that happens to be, at the moment, labor problems, but this legislation would deal with two of these issues. It would give the Department of Transportation an increased role in the merger review process, and it would ensure that underutilized gates, slots, and facilities are available for competitive purposes and ensure that the capacity of the existing system is fully utilized.

The General Accounting Office has pointed out that low-cost competition has been a driving force behind the benefits seen by the industry since deregulation. A recent Department of Transportation study found that passengers pay 41 percent more at dominated hubs than passengers who fly in hub markets with low-fare competition.

I don't think that anyone would disagree that competition benefits the consumer. Southwest Airlines has brought enormous benefits to the communities it serves. The "Southwest effect" is now a commonly used term to describe lower fares and increased economic benefits.

On a slightly lesser scale, JetBlue and AirTran have brought tremendous competition, reduced fares, and benefits to the communities they serve. However, JetBlue was able to achieve its remarkable success due to a 75-slot exemption granted to it at Kennedy

Airport by the Department of Transportation. AirTran took advantage of Eastern Airline's difficulties to acquire the gates and facilities that Eastern had at Atlanta.

Most observers would agree that these occurrences, which provided significant new-entrant opportunities in busy areas, were anomalies in the market.

Hub airports are particularly difficult to get a foothold in. Dominant carriers hold tremendous leverage and power and use it to stifle competition. Slots, gates, baggage carousels can all be very hard to obtain by a new entrant in these conditions. Allegations of hording of slots and gates have been presented many times before Congress. Predatory pricing remains an effective means of forcing competition out of business.

The current proposed mergers would give several airlines increased market share and substantial increased ability to wipe out competition. One need only listen to new entrants trying to get a foothold in a hub airport or look at the recent example of the competitive response Legend Airlines faced at DFW to see how new entrants are being treated.

I'm sure the airlines will complain about this bill as Federal intervention or meddling in their industry; however, I note that they seem to be welcoming Federal intervention on the labor front. Competition is a necessary integral piece of our aviation system. This bill will take steps to improve the situation.

I know that many people are anxious to address delay and capacity issues. I believe that this bill is another piece to solve the problems facing the system today. However, we will continue to focus our efforts on capacity and delay issues also.

I am gravely concerned about the status of the airline industry. Just yesterday, FAA forecast that there will be 1.2 billion passengers flying by the year 2012. We must continue to look for solutions to aviation's increasing problems. I'm committed to holding hearings and crafting legislation to attempt to combat these problems.

I look forward to working with my colleagues on the Committee, especially Senator Hollings, as we continue to work toward a common end.

Senator Hollings.

[The prepared statement of Senator McCain follows:]

PREPARED STATEMENT OF HON. JOHN MCCAIN, U.S. SENATOR FROM ARIZONA

Today the Committee will hear testimony on S. 415, the Aviation Competition Restoration Act. S. 415 was introduced by our distinguished ranking member Senator Hollings. I was one of the original cosponsors of this bill. I worked closely with Senator Hollings on this issue to attempt to craft legislation that would effectively address some of the shortcomings in our aviation system today.

The airline industry is in turmoil. There are numerous reasons for these problems, which can be lumped into four major categories: mergers, competition, delays and capacity. This legislation would deal with two of these issues. It would give the Department of Transportation an increased role in the merger review process and it would ensure that underutilized gates, slots and facilities are available for competitive purposes and ensure that the capacity of the existing system is fully utilized.

The General Accounting Office has pointed out that low-cost competition has been a driving force behind the benefits seen by the industry since deregulation. A recent DOT study found that passengers pay 41 percent more at dominated hubs than passengers who fly in hub markets with low-fare competition. I don't think that anyone

would disagree that competition benefits the consumer. Southwest Airlines has brought enormous benefits to the communities it serves. The "Southwest effect" is now a commonly used term to describe lower fares and increased economic benefits.

On a slightly lesser scale, JetBlue and AirTran have brought tremendous competition, reduced fares and benefits to the communities they serve. However, JetBlue was able to achieve its remarkable success due to a 75 slot exemption granted to it at Kennedy Airport by the Department of Transportation. AirTran took advantage of Eastern Airlines' difficulties to acquire the gates and facilities that Eastern had at Atlanta. Most observers would agree that these occurrences, which provided significant new entrant opportunities in busy areas, were anomalies in the market.

Hub airports are particularly difficult to get a foothold in. Dominant carriers hold tremendous leverage and power and use it to stifle competition. Slots, gates, baggage carousels can all be very hard to obtain by a new entrant in these conditions. Allegations of hoarding of slots and gates have been presented many times before Congress. Predatory pricing remains an effective means of forcing competition out of business.

The current proposed mergers would give several airlines increased market share and substantial increased ability to wipe out competition. One need only listen to new entrants trying to get a foothold in a hub airport or look at the recent example of the competitive response Legend Airlines faced at DFW to see how new entrants are being treated.

I'm sure the airlines will complain about this bill as federal intervention or meddling in their industry. However, I note that they seem to be welcoming federal intervention on the labor front. Competition is a necessary, integral piece of our aviation system. This bill will take steps to improve this situation.

I know that many people are anxious to address delay and capacity issues. I believe that this bill is another piece to solve the problems facing the system today. However, we will continue to focus our efforts on capacity and delay issues also. I am gravely concerned about the status of the airline industry. Just yesterday, FAA forecast that there will be 1.2 billion passengers flying by 2012. We must continue to look for solutions to aviation's increasing problems. I am committed to holding hearings and crafting legislation to attempt to combat these problems. I look forward to working with my colleagues on the Committee as we continue to work toward a common end.

STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

Senator HOLLINGS. Well, thank you very much, Mr. Chairman for calling this hearing—and you and the other sponsors for helping us in this move. I'm faced with a typical senator's problem of having time down on the floor, but it's only limited to a few minutes, and I'll have to excuse myself and come back. I would ask that my statement be included.

The CHAIRMAN. Without objection.

Senator HOLLINGS. I'll make a deal with you. I'll give you all the slots you want in Washington if you give me Southwest Airlines down in South Carolina. How about that?

[Laughter.]

[The prepared statement of Senator Hollings follows:]

PREPARED STATEMENT OF HON. ERNEST F. HOLLINGS, U.S. SENATOR FROM SOUTH CAROLINA

Mr. Chairman, I want to thank you for convening this hearing. You and I introduced legislation almost two weeks ago focused on competition, or rather, the lack of competition in the airline industry. If we are to have mergers, and also continue to see higher concentration levels at hubs, then somehow, someway, we must ensure that competition can co-exist for all markets. I often have said that 85 percent of the short haul markets are subsidizing the 15 percent of the long haul markets. My point is that on the short haul, monopoly routes, the carriers charge what they want. They then compete on the long haul, and one stop markets through the hubs.

Mr. Chairman, it is time for the Congress to really understand what is going on in the airline industry. It is an industry that no longer competes. Passengers no longer matter. We are like cattle in a stockade.

The bill we are focusing on today seeks to restore the public's interest in our aviation system, to reclaim it from the carriers. We have a number of cosponsors—Senators Dorgan, Grassley, Reid and Wyden. I appreciate their recognition that something has to change.

With the introduction of the bill, the major airlines have been gearing up to stop the bill. That should tell us all something right there. I know we need hubs, and that hubs enable the major carriers to serve small communities. This bill does not, despite their rhetoric, threaten small community service, and we will ask GAO to comment on that later. All the bill does is make sure that there is room for competition and new service. The major carriers seem to believe that if they have 85 percent of a market, and have to give up a little space to someone else, somehow we have forced them to cut service to the most vulnerable places. They also know that by making that argument, many may be susceptible to that argument.

When we deregulated this industry, we were told that small communities would be well served, and that all would be well. As I look around this Committee, I know many of us do not believe that, and this bill attempts to fix the problem. Either we will have competition or we won't. Its not a hard choice.

This bill injects a dose of plain commonsense to reviewing transactions—it does not, as opponents claim, kill any specific merger. We should not be faced with a situation where we either support 2 complicated acquisitions, or else we are labeled as killing jobs. That is not the case. Put TWA in a different box altogether. I do not like the fact that St. Louis will have one carrier with 76 percent of the traffic, but it does have a growing presence from Southwest, so fares should go down because of real competition. In addition, TWA clearly is in extreme financial difficulties. That is a matter for the bankruptcy Court and the Department of Justice's review right now under the failing company doctrine. Our bill enables TWA to make its case to DOT in a similar vein, but if we need to explicitly carve out a bankruptcy exception, we will consider it.

We have spent countless hearings listening to various airline executives, government officials and expert witness talk about the problems confronting the traveling public. It is time we put all of that information and knowledge together to benefit the traveling public.

Let's start with the hubs. There are 20 major airports, essential facilities, where one carrier has more than 50 percent of the total enplaned passengers. Study after study has told us, warned us, that concentrated hubs lead to higher fares, particularly for markets to those hubs with no competition. Average fares are higher by 41 percent, according to DOT, and even higher for smaller, shorter haul markets, by as much as 54 percent. DOT estimates that for only 10 of the hubs, 24.7 million people are overcharged, and another 25 to 50 million choose not to fly because of high fares.

We have got to take a can opener and pry open the lids to the hubs—without competition, whatever benefits deregulation has brought, will quickly fade away. Our legislation will ensure that other air carriers have the ability to compete, the ability to provide people with options, and the ability to threaten to serve every market out of the dominated hubs. Gates, facilities and other assets will need to be provided where they are unavailable, or where competition dictates a need for such facilities. Dominant air carriers have relied upon Federal dollars to expand these facilities, and they have taken advantage of those monies by establishing unregulated local monopolies. It is time to use the power and leverage of the Federal government to restore a balance to the marketplace.

Right now, the air carriers are attempting to dictate what the industry will look like. If they are successful, all of the concerns raised by countless studies, will not only be realized, but they will be exacerbated. The public's needs, the public's convenience, are something that must be first and foremost as we watch this industry evolve.

Airline deregulation forced the carriers to compete on price for a while, but not on service. Congress had to threaten legislation in 1999 before the airlines even began to even understand the depth of consumer anger towards the airlines. Today though, they no longer compete on price. Instead, they seek to acquire one another to create massive systems - perhaps only three will survive, leaving us all far worse tomorrow than we are today. And clearly today, we are not getting what is needed.

What are the facts: United wants to buy US Airways, and create DC Air. American wants to buy TWA, a failing company with a hub in St. Louis, and then American wants to buy a part of US Airways. Continental and Northwest have a 25 year marketing relations, and Delta, Continental and Northwest are all eyeing other deals.

Right now there are 20 major cities where one carrier effectively controls airline service. Department of Transportation, General Accounting Office, National Re-

search Council and others have all documented abuses, high fares, market dominance, hoarding of facilities at airports so other carriers can not enter, and let's not forget poor service. It must stop. It is not enough for the antitrust laws to look at each transaction in a vacuum. The public's interest, its needs, and its convenience must be reasserted.

DOT, in its January 2001 study, made three key observations:

1. The facts are clear. Without the presence of effective price competition, network carriers charge much higher prices and curtail capacity available to price sensitive passengers at the hubs. . . . With effective price competition, consumers benefit from both better service and lower fares", citing Atlanta and Salt Lake City as examples where a low cost carrier is able to provide competition to a dominant hub carrier.

2. "The key to eliminating market power and fare premiums is to encourage entry into as many uncontested markets as possible"

3. ". . . barriers to entry at dominated hubs are most difficult to surmount considering the operational and marketing leverage a network carrier has in it hub markets."

In its 1999 study, the Department stated most clearly what we are trying to achieve: "Moreover, unless there is a reasonable likelihood that a new entrant's short term and long term needs for gates and other facilities will be met, it may simply decide not to serve a community". FAA/OST Task Force Study, October 1999, at page iii.

I urge my colleagues to cosponsor this legislation.

The CHAIRMAN. If I'm made the CEO of Southwest, I will find that fairly easy to do.

[Laughter.]

Senator HOLLINGS. What happens is—we're here this morning because this is very timely. NBC Dateline's got a program on, after an 8-month investigation, this evening. And I'm told, just coming here, that the bill is really intended to go against the mergers.

I'm not necessarily for these mergers. There is a Dorgan bill that I intend to cosponsor, but this bill isn't to stop mergers or to break the airlines. The airlines, themselves, come and testify at that conference table that, "Look, you've either got to approve my merger—namely, I've got to have a monopoly—and extend that monopoly, or I've got to go into bankruptcy." We've had the chairman of the board say just that.

That's a pretty desperate situation for capitalistic enterprise. And what has really happened in the deregulation of the airlines is, about 85 percent of the communities are subsidizing the 15 percent long-hauls; and otherwise. The airlines themselves, because money controls, have concentrated and now control 20 airlines, over 50 percent of the landings and takeoffs at the airports in this country.

And I would hope, like down in my own backyard where, in Charlotte, North Carolina, US Airways controls 91 percent of the landings and takeoffs, we can inject some competition. This won't be, in and of itself, the solution.

Obviously, if we open up some of those slots, what happens is, "Let's get me 20 slots, and they've still got 70 percent of the landings and takeoffs, they can still, more or less, control things by lowering the prices and everything else of that kind." The FAA has to look at the predatory pricing statutes and make sure they follow through.

This is a small initiative to allow those airlines—or rather, those airports to begin to control themselves. What really happened is—in the olden days, the communities, like my own city, the county wouldn't build an airport, so we went out into the county, we built

the airport, we went to Captain Eddie Rickenbacker, and we—Eastern came, and we all ventured to Washington with the Civil Aeronautics Board. We got approval for the particular routes, the slots, the prices, and the times of day and everything else, and it was a sweetheart deal between the communities and the airlines and the travelers.

I had made the statement about a round-trip, coach—I get the government fare, but my wife—I buy her a ticket, and it was $917 just this last week. The fellow came up to me as I was catching the flight back to Charleston last Thursday night, and he said, "You complained about $917. I just paid $976 for the same round-trip ticket." The public convenience and necessity and the need for quick travel and everything else has totally gone out of the window, and all kind of machinations with money-controlling has come into effect. This will begin to open up, I would hope, some of that monopolistic control where you can inject some competition, the original intent of deregulation. What we're trying to do is not hurt the airlines, or anything else like that, but to inject some public convenience and necessity, some competition back into it where we know those $917- or $976-fares, which are outrageous, to fly to and fro, will go out of the window and we'll get back to some semblance of the good service that we had when we had some good competition going and had good service—and many of the particular hubs were served by more than one airline, but by several airlines.

So I thank you very much. I'll have to excuse myself, but I'll be right back.

The CHAIRMAN. Thank you, Senator Hollings.

Senator Burns.

STATEMENT OF HON. CONRAD BURNS,
U.S. SENATOR FROM MONTANA

Senator BURNS. Thank you, Mr. Chairman, and thanks for holding this hearing today. And, you know, we'd all like to operate in a perfect world, but we do not. We understand that.

On this particular piece of legislation, I think the oversight of two different departments on these mergers is probably a good thing. We have to look at mergers, and we have to look in DOJ, with the antitrust and everything else, and they're charged with that responsibility, and I think that's the good part.

On one hand, I'm concerned, though, that mergers and their impending downstream effects will further exacerbate this situation if you look at it; on the other, I'm quite confident the domestic airlines have served the traveling public much better following deregulation than they did in the mid-'70's.

But even in the most perfect worlds, we still face pockets of inequity, as we do in the rail industry. I do think it's important that my colleagues—and on this panel, we recognize the intention of the bill we're addressing today as a comparison to the very similar economic situation that we faced in the rail industry. And I intend to introduce legislation and call it the Railway Competition Restoration Act and will address the similar economic inequities of the rail industry.

If enacted, the bill we are considering today will give the Department of Transportation specific authority to determine whether or

not a merger or acquisition is in the public's best interest. Duel oversight and interaction between DOT and the Department of Justice would provide the traveling public with additional safeguards to ensure our domestic airline network doesn't result in the fate of the current railroad industry.

I commend the authors of this bill for including that provision; however, I still have some concerns that the provision would give the Federal Government the ability to further control slots at our nation's airports. We should be opening up these slots to competition, not granting authority to take away or reassign them.

Furthermore, I'm concerned that redistribution of the assets of the carrier-dominated hubs would have a significant impact on rural-state service to small and medium airports, that such characterized by ours in Montana.

In the case of Salt Lake City, if 10 percent of the dominating carrier slots were reassigned, that may reduce the service to Montana. There is no assurance that the carrier gaining those assets would serve my State at all. In fact, I can think that we can all agree, an acquiring carrier would be likely to serve the larger market where profits are much higher.

So, Mr. Chairman, I think that you and the ranking member have come up with an idea here that basically is a good idea. If Mr. Hollings wants to get into the big leagues of fares, why tell him to fly to Montana sometime. That's the big leagues there, I'll tell you.

But nonetheless, I think this legislation can be massaged and can be worked to where it will be a workable product. And I appreciate this hearing today, and I appreciate your participation in it, and thank you.

The CHAIRMAN. Thank you, Senator Burns.

Senator Hutchison.

STATEMENT OF HON. KAY BAILEY HUTCHISON, U.S. SENATOR FROM TEXAS

Senator HUTCHISON. Thank you, Mr. Chairman. I'm looking forward to beginning a dialog with you about the solutions to the gridlock and customer dissatisfaction that is pervasive in the aviation industry today. By now the statistics are familiar: one in four flights are delayed or canceled—450,000 flights last year delayed or canceled.

Along with the Chairman and Ranking Member, I'm cosponsoring a bill that will force the airlines to disclose better delay and fare information to consumers and hold them to their commitments to improve customer service. I'm pleased to see that our bill, the Airline Customer Service Improvement Act is on the markup agenda later this week.

I cannot say the same about the bill that we are considering today. I have grave reservations about this legislation. If enacted, S. 415 would impact airlines and airports in two distinct ways. S. 415 gives the secretary of Transportation broad new authority over the use of gates and facilities by airlines at the nation's largest airports.

Second, it adds a new government review standard and procedure with regard to proposed mergers and transactions.

Like many of my colleagues, I'm concerned about the concentration of the aviation industry and the economic conditions leading to this phenomenon. It is true that smaller airlines are having a difficult time gaining access to the nation's large airports. However, I believe this bill takes the wrong approach to dealing with this situation.

I am working with Senator Stevens and other colleagues to develop legislation to streamline the environmental review process. This morning, the FAA released a report indicating that we are, in fact, facing a capacity crisis. I believe that building new runways, terminals, and airport facilities and upgrading air-traffic control capabilities are the best way to provide competitive access to aviation facilities.

Creating new barriers to mergers and acquisitions in the aviation industry is like closing the barn door after the horse has escaped.

Secretary Mineta recently indicated the Department of Transportation will conduct an in-depth analysis of the competitive aspects of all proposed mergers and acquisitions in the industry, but the final judgment rests with the Department of Justice, and it should remain there.

The Department of Transportation review called for in this bill is redundant. The proposed United Airlines acquisition of US Airways is under review by the Justice Department and the Department of Transportation. Last week, Federal regulators announced the latest in a series of delays of the transaction to deal with their concerns. Clearly, this deal is receiving a thorough review from the Justice and Transportation departments. Creating new hurdles for the merger is overkill.

As for the other merger on the drawing board, the American buyout of TWA is a rescue mission to save a major carrier and a major employer from liquidation. Still, the acquisition is properly under review.

More serious are the implications of the bill's other section which deals with airline hubs. S. 415 requires the Department of Transportation to review utilization of gates and other assets at the nation's largest 35 airports and reassigns the facilities to smaller carriers in the name of improving competition.

This state-sponsored redistribution of assets amounts to re-regulation. It would disrupt airline services throughout the country. Under S. 415, airlines must also surrender gates as a consequence of completing a merger. Major carriers could lose gates at critical airports, leaving their passengers with fewer options.

The last time I checked, the average flight was running pretty close to full. Every airline passenger is familiar with the phrase "middle seats only." Taking away gates from carriers at their hubs will mean even less capacity for travelers. At DFW Airport, the gate situation is so bad, I have spent an hour or more after landing waiting for an open gate.

Mr. Chairman, I believe the way to promote competition and improve service is to build more capacity, not restrict the limited resources we have. Under this bill, we could take gates away from carriers, and give them to smaller competitors who may not be able to utilize these resources for the best passenger service.

While I cannot support this legislation, I appreciate the opportunity to work with you and the Committee to address the problems we all acknowledge. Thank you.

The CHAIRMAN. Thank you very much, Senator Hutchison.

Senator Fitzgerald, would you care to make a——

Senator FITZGERALD. I'll pass.

The CHAIRMAN. Thank you. Then I want to welcome the first panel, which is the Honorable Thomas J. Miller, the Iowa Attorney General; Ms. JayEtta Z. Hecker, the Director of Physical Infrastructure Issues, U.S. General Accounting Office; Mr. Glen Hauenstein—he's Senior Vice President of Scheduling at Continental Airlines; Mr. David Neeleman, Chief Executive Office of JetBlue Airways; Mr. Mark Kahan, who is the Executive Vice President and General Counsel of Spirit Air Lines; and Dr. Mark N. Cooper, Director of Research, Consumer Federation of America.

And we will begin with you, Attorney General Miller. Welcome again before the Committee, and it's good to see you again.

STATEMENT OF THOMAS J. MILLER, ATTORNEY GENERAL, STATE OF IOWA

Mr. MILLER. Thank you. It is good to see you, as always, Mr. Chairman.

About 35 attorney generals have been working on this issue of airline competition, and we've done that for many of the same reasons that you're working on the issue and that you've brought forth this legislation. I think we all recognize that deregulation in the airline industry, on balance, has been an enormous plus for consumers and for the country, but there are areas where that competition does not extend, and they're areas throughout the country. In Iowa, we have some of those areas. Upstate New York, until recently, lacked competition. Richmond, Virginia, had some of the highest rates in the country—Tallahassee, Florida, the same thing.

So you have interest in at least 35 State attorney generals. Indeed, some of them said, Senator Burns, instead of pockets of inequity, there were pockets of competition in those states. So the whole idea is to spread the benefits of deregulation as far as we can throughout the country, and the main way to do that is through competition—through low-cost carriers, through new entrants—through competition, not through re-regulation.

And that is the goal, certainly, of the 35 attorney generals, to have greater competition in more markets so that we all can have the benefits.

And we also recognize, and I think you do, too, that—where the prices are very high in city pairs, they're highest for the business traveler. That's where you get the extraordinary high rates. And that can have consequences for economic development in a community. So it reaches to the core economic interest of some of our cities and states.

The first thing we need to do is not make it worse. And what you're doing here is giving the DOT authority on mergers. The thing that could make the whole situation even worse is more mergers. You give them the authority to stop a merger; you give them the authority, if they approve a merger, to reallocate some of

the gates and slots. And I think that that kind of authority is very important to make sure that there is no further harm.

Then you do other things to improve the situation. You focus on gates and slots. And for a long time we concentrated on pricing and slots and somewhat ignored gates as a key issue here. One of the really positive things that you do with this legislation is put gates on the map as something that's very important and give DOT the authority to work in the area of gates; because even if an airline has slots, or if it's a non-slot airport, if they can't get a gate, they can't fly.

And we've seen situations where for long periods of time new entrants are not able to get gates.

What we've seen over the last few years is an evolution in terms of the DOT—a very positive evolution, I think. DOT was given authority—broad, basic authority to prevent unfair methods of competition in the deregulation legislation in the late 1970's and, for one reason or another, for a while didn't need to use that authority. But now they really need to use that authority.

We think Secretary Slater brought us forward in that area by proposing the guidelines for price competition. And then coming out with a report and establishing a basis for DOT to take action against predatory pricing situations was very positive. He did some things in the area of slots—I think the Chairman mentioned the 75 slots at Kennedy—Secretary Slater was sensitive to that. I think he did a study on gates, as well.

Now, with the new secretary, Secretary Norman Mineta, his positive statements recently on the mergers indicates, I think, a real continuation at DOT in this area and a positive one.

I think that what you're doing here, particularly in terms of gates, is giving what I might say "permission" for the DOT to act. You know, arguably, by the broad authority, they can do quite a few things in regard to gates; but when you don't use authority for long periods of time, and there's very entrenched interest opposing that, it's difficult for an agency to then all of a sudden use that authority.

What you're doing here, on the gates, in particular, is giving them permission and a specific authority—a specific procedure to deal with the gate situation—I think that's very positive.

You do not take any authority away from the Department of Justice, in terms of merger, and I think that's very important. I think the Department of Justice was given authority maybe 10 years ago in this area, and they're using their authority very well. They have brought the case, the American Airlines, case. They're reviewing the merger, as Senator Hutchison mentioned.

It's very important that when you give additional authority here to DOT, you do not take it away from DOJ, and you do not.

In summary, this is a difficult set of issues, a very complex set of issues with a lot of different pieces. There's no magic solution that's going to bring price competition immediately to Montana or Iowa, but there are things that we can do along the way that are going to increase that. And it seems to me in this bill, you address a number of them, particularly highlighting gates.

And there's also an intangible here. The Senate is much more engaged now on these issues, through Senator McCain's leadership

and the efforts of others. And this is a very important intangible in dealing with this whole set of issues to try and bring competition to greater parts of America so that we can all enjoy the benefits of deregulation.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Miller follows:]

PREPARED STATEMENT OF THOMAS J. MILLER, ATTORNEY GENERAL, STATE OF IOWA

I appreciate the opportunity to appear before this Committee today. As a point of departure, I believe we can agree that we are now at a particularly critical juncture in the nation's efforts to create a competitive airline industry. Travelers and the business community alike are keenly aware that a major airline consolidation effort is proposed that would have seemed incredible to industry experts just a few years ago. If this consolidation isn't halted, we have to consider the possibility that the entire U.S. air transportation industry may be in the hands of three or four major companies within the next few years.

THE UNEVEN IMPACT OF DEREGULATION

Deregulation of the airline industry has largely been a success with better service and better prices for the traveling public. Nonetheless, in many areas of the country, we have witnessed more costly airfares, a reduction in new entrants into air markets, and lessening competition among the major carriers with their grasp on key hubs. We have come to understand how fundamentally the lack of real competition and meaningful access to air service is linked to the economic development and vitality of our communities and states in addition to its impact on the leisure traveling public.

INITIATIVES OF STATE ATTORNEYS GENERAL

Over the past three years I worked closely with over thirty-five state attorneys general who have learned that the benefits of deregulation have yet to be realized in significant parts of the states that they represent. Having formed a multi-state Airline Working Group, the States have taken concrete steps to ensure access to the advantages of deregulation for their citizens, especially through the support of an open and fair competitive environment in which low-cost and new entrant airlines can compete on a level playing field.

In the course of this effort we have learned a great deal. We have worked closely with others interested in these issues, including the Department of Transportation, the Department of Justice, as well as the Congress. We have also met with and listened to key consumer and industry groups on numerous occasions. We filed several sets of comments on proposals that were being considered by the Department of Transportation for dealing with the problem of unfair competition against new and emerging small carriers. And we contributed to the work of the National Transportation Research Board in its study of these same issues.

Currently we are examining dedicating substantial resources to investigating the airline mergers that have been announced, as well as looking into the possible impact of Orbitz, the airline owned internet ticket business currently in the formulation stage.

BENEFITS OF COMPETITION AND INCREASED AIRPORT ACCESS: SPECIFIC EXAMPLES

In certain fortunate markets we have learned clear lessons about the benefits of competition to the consumers and business communities. Competition among the major airlines in our airports is a good start for our traveling public. We have also come to realize that low cost carriers can be a real asset for generating competition. One low cost carrier showing consistent growth reports that when it enters a new market that fares to the new markets that it serves are reduced by fifty percent and the passenger traffic increases by one hundred percent. I think that a few examples effectively illustrate this point.

Recently upstate New York has seen the advent of a local low cost carrier which has created immediate and significant competition for passengers with the result that some communities went from experiencing some of the highest prices in the nation to very competitive prices. In the hub city of Atlanta, a low cost carrier has moderated prices significantly for travelers in many city pairs.

When the Department of Transportation has elected to become proactive in encouraging competition through the distribution of slots, we have witnessed real competitive results. The provision of 75 slots at Kennedy airport in New York to a new

low cost carrier, for example, has generated competition in numerous key markets including the traditional high cost area of upstate New York.

On the other hand, the historical trend can be seen with the acquisition of TWA by American Airlines. At National Airport in Washington TWA has 49 slots—all of which may go to American—giving that carrier a total of 390 slots at this airport which is one of the most important in the nation to travelers. This is precisely the circumstance which this bill is designed to address. Parenthetically, we believe it is already possible and entirely appropriate for the Department of Transportation to shift a number of these slots to competitors, especially low cost carriers which wish to enter the market but are prevented from doing so by the barriers to entry that we noted earlier.

Examples abound of the barriers to entry presented by a lack of gates, including such constricted locations as Boston and Philadelphia. When gates have been made available the results are good for competition and consumers. A low cost carrier fought for over a year to get gates at Newark where majors held control of the airport. In a number of instances the gates were not being fully utilized but were withheld from carriers trying to obtain space to run their operations. When the gates were finally opened, a reduction in prices to the markets served by this new competitor were immediately felt by local travelers. A similar story can be told about another small carrier, who after a two-year effort finally succeeded at obtaining gates at Detroit, to the benefit of consumers.

I would like to touch upon one final point I believe merits this Committee's consideration. While major airlines challenge the studies showing that consumers pay a premium at hub airports—often called fortress hubs—, it seems fairly clear to most of us that the premiums are real and frequently substantial. When a competitor, especially a low cost carrier, is allowed to enter the market and compete for local traffic, the outcome is telling. In Atlanta a low cost airline has challenged the incumbent carrier in its own hub and prices to communities served by that airline have dropped substantially. We feel that this needs to occur elsewhere to provide the benefits of competition to consumers living in hub cities and this bill helps us do that. Again, we believe that the DOT can take steps to promote this healthy competition using its own authority.

S. 415 AND AIRPORT ACCESS: IMPORTANCE OF SLOTS AND GATES TO COMPETITION

We come before this committee in support of efforts by this Congress to pass legislation that will ensure a fair and equitable opportunity for competing airlines to obtain slots and gates and thereby access to key airports in our country.

Our involvement with airline issues has taught us that one of the primary factors that impedes competition in the industry lies in the ability of airlines to dominate individual airports. Quite obviously if competing airlines cannot get access to an airport, competition is impossible, regardless of any other factor. In our view, airport access is a key to a real competitive marketplace. Access refers to both the physical space and also the vital time periods when people want to travel.

Our current system consists of a unplanned mixture of airport rules, transportation regulations, lease obligations, and squatters rights, that allow individual carriers to gain significant power to control access to individual airports. These conditions allow carriers such as Northwest to dominate the hub at Minneapolis-Saint Paul, for United and American to dominate O'Hare in Chicago, and for Delta to dominate Atlanta. And the most remarkable thing about this phenomenon is that it is effective against even the most powerful competitors in the industry. Not only making it difficult for small carriers to serve Chicago, Atlanta and Washington, the lack of access curbs the major carriers' ability to compete effectively in those markets as well.

Air transportation is a network business. That is, successful airlines have come to believe fervently in the idea that their growth and prosperity depends on their ability to fly everywhere, to offer major corporations and travel agencies unlimited options for reaching any destination. However, this desire to create a complete network collides head-to-head with the airport access problem.

We know that true and effective competition cannot be mandated or regulated. But what the government can and has the duty to do, is address the artificial structural barriers to entry created by arcane airport access rules as well as de facto control of certain airports by the major carriers. We believe that these tactics are stifling competition.

SUPPORT FOR THE GENERAL PRINCIPLES OF S. 415

Airports are public facilities which must be accessible to all competitors on reasonable terms. As more and more people crowd the airlines, it is of paramount im-

portance that the government devise a means of insuring that competitive initiatives are not thwarted as a result of structural conditions at the airports. Consequently, we strongly support efforts to create a better system for the allocation of gates and slots.

As we understand it, the underpinning of S 415 is twofold:

- To grant the Department of Transportation greater power to approve airline mergers and acquisitions under new standards, and
- To address more effectively the problem of the allocation of slots and gates.

FOCUS OF ENFORCEMENT: DOT AND DOJ

First, I want to note at the outset Transportation Secretary Mineta's recent commitment to place more emphasis on ways the Department can take a more proactive role in addressing crucial issues in the airline industry. This is a development that we welcome.

For some time we have recognized the potential for DOT to play a significant role in promoting competition in the market. In January, Secretary Slater and the DOT staff produced several papers that outlined the authority the Department already has to address anti-competitive behavior in the industry. In this regard we believe that the Department of Transportation currently has authority to take actions in regard slots and gates when their allocation becomes an impediment to competition. That authority is embodied in current statutes and has existed for many years. However, to date it has not been employed effectively.

To the extent the S. 415 further develops and enhances the Department's authority specifically to open access to airports through modest redistribution of slots and gates, it could move us closer to the open competitive environment we are seeking. Any legislation that focuses on restructuring the rules that govern airport access will address one of the most significant impediments to competition in the industry and the factor that is leading to these unprecedented consolidation efforts.

I would emphasize that I do not believe that we should in any way withdraw authority to review mergers from the Department of Justice. In working closely with the Justice Department on many investigations of all kinds in the past, I have come to have great respect for the Department's resources, its depth of knowledge, and its commitment to applying the appropriate standards in an objective manner. I would note that it has not been that long since the Justice Department has had primary responsibility for addressing airline acquisitions. Changes regarding the primary responsibility for airline mergers should be made only when a reasonable degree of confidence can be developed that we are proceeding in the right direction.

ACCESS TO AIRPORTS: OPENING SLOTS AND GATES TO COMPETITION

A principal feature of the bill is to shift slots and gates to foster real competition in markets. When the States were participating with the Transportation Research Board in its examination and evaluation of competition in the airline industry we began to clearly understand the importance to meaningful competition of access to airports through the provision of slots and gates. Indeed, the TRB recommended letting pricing and market-based methods of allocating slots drive access to markets for competitors to the entrenched major carriers.

The TRB went on to observe that a long history of government involvement with the major carriers and with the airports themselves had created an artificial barrier to entry for competitors. Consequently, they suggested that airports should take steps to assure a sufficient availability of gates to competitors wishing to enter the market, including allowing for the purchase of gates from dominant carriers controlling gates at the airport. They additionally urged that the Department of Transportation monitor the availability of gates and presumably take steps within its authority to resolve existing conditions in favor of competition for local passengers.

S. 415 seems to me to state categorically and unequivocally that access to our key airports through the provision of gates and slots is crucial to promote competition that will serve the interest of business and leisure travelers across the country. Even in the event that this bill does not become law, this Committee has provided a blueprint for future competition. The dialogue here today will provide greater awareness and useful information about how we can open our airports to the clear and convincing benefits of competition. Time will tell whether these standards work and whether they are effective in this industry.

CONCLUSION

I note that there is still much to learn about the airline industry. There are limits on our ability to see into the future that we must respect. What we do know with reasonable assurance is that the lower the barriers are to entry in the marketplace,

the more likely it will be that consumers will find the choices they prefer at the lowest possible price. Increased access to our nation's airports through the provision of slots and gates to competitors will enhance the opportunity for healthy competition that will extend the benefits of deregulation to communities across the nation. We applaud your proposals to spur real competition in the airline industry.

Thank you for the opportunity to appear before you today.

The CHAIRMAN. Thank you very much, Attorney General Miller. Ms. Hecker, welcome back before the Committee.

STATEMENT OF JAYETTA Z. HECKER, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GENERAL ACCOUNTING OFFICE

Ms. HECKER. Thank you, Mr. Chairman. I'm pleased to be here today.

And the focus of our remarks really are, as the title our statement covers, the challenge is really in enhancing competition, that really the focus here, as the intent of the bill makes clear, is to ensure competitive access by commercial carriers to markets. And that's probably the single most important factor to getting competition to work, to ensuring the benefits are spread more broadly across the population.

I'll focus on three things today. First, an overview of the status of deregulation and airline competition, how well it's really working, briefly talk about Federal oversight and enforcement of competition, and then finally offer some limited observations on the proposed legislation.

I think it's often helpful to kind of give you the sense of where I'm going to go with this, so I give you the three answers to the three questions right away. In our view, the State of competition is in jeopardy. There are severe limitations, and that is something that really matters to a significant part of the population and the economy. The State of Federal oversight, in our view, is limited. And, finally, our observations on the bill—we have full concurrence with the intent of the legislation, although we have some very specific concerns on some of the aspects, and I'll repeat those very briefly.

The first area, then, in the State of competition—there's really two ways to look at this. First, is concentration—market power or domination at hubs. And if you have the statement before you, I have a map on Page 6 which lists all of the airports hubs that are dominated. And I think you see that they range from 50 percent to well over 90 percent. And these are clearly—the 16 of the 31 major hubs, and all of the major hubs are dominated by the carrier that's present there.

Now, the next thing, though, is that domination, by itself, really is not market power, and it's certainly not the exercise of market power. So the next thing to turn to is, what's the evidence of the possible harm that comes from this domination. And we look at two things. We look at fares, and then we look at possible exercise of barriers to entry.

On the fares, this issue has been studied for years, and there is really constant repeated evidence from all the research that dominated hubs tend to have higher fares. The most recent study that you, yourself, referred to out of DOT, made it very clear—because it looked within the hubs, and it looked at the markets that had

low-fare competition and didn't. So the city pares out of the dominated hub.

And, as you said, the markets where there was no competition had 41-percent higher fares, and even over 50-percent higher fares in the short-haul market. So the evidence is really conclusive that there are some problems with higher fares in dominated markets.

But the other side of this is also to look at possible exercise of market power to restrict entry. And this is something that affects not only the use of airport facilities, which this bill focuses on, such as gates and counters and baggage facilities and slots, but also there are marketing and operating characteristics of airlines where there is the potential for exercise of market power and the restriction of entry. And we've done many reports on this and, in fact, concluded several times that there are some real problems.

I could say more, but I'll move on quickly to the second issue on the status of Federal oversight. The Airline Deregulation Act clearly contemplated an active oversight role, not only from Justice enforcing the Antitrust laws, but from the Department of Transportation enforcing unfair trade practices laws. And our review of the kind of exercise of that authority over the past decades is really that very limited action has been taken.

This basically leads to the third area that I'll cover, which is comments on the legislation. And what we so fully concur with is that the real intent of the legislation, as we read it, is to direct DOT to take a more active, affirmative, pro-competitive oversight role using existing authority, and, as has been discussed, to some extent, giving them some new authority.

What's key about that is that the legislation really focuses on the single most important impediment to competition, and that is problems with entry. And that clearly is an important thing to focus on, because the benefits of preserving and enhancing competition are indisputable, and access to markets is the key factor that's behind the lack of functioning of competition.

Now, the concerns we have really are that the legislation may be more prescriptive than necessary and, in fact, have more detailed roles and actions by the department that, themselves, could further exacerbate some of the competition.

A couple of the points that I mentioned in my statement, it's actually not clear that the forced divestiture of airport facilities would even result in real competition in some high-value markets, because new competitors may or may not have a cost advantage relative to the incumbent. They only have to have under 15 percent of the market share to be able to get access. And, as we know, not all carriers really compete on price.

Now, there's another issue that I know there's a lot of concern on in the Congress, and that is that the potential forced divesture could result in the reduction of service to smaller communities.

Let me say, though, that the broader strategy of having an activist DOT role, in our view, is not to force more administrative controls and choosing of winners and losers and administrative allocation of slots and gates by presumably all-knowing officials in the Department of Transportation. It's our sense that there's really an important urgency to move away from administrative allocation of assets, which is most significantly typified by the way slots have

been managed for the last 30 years, and to apply more market-based principles to the allocation of scarce facilities.

What this goes to is actually something Senator Hutchison was referring to, and it's really the use of the pricing mechanism to not only address the critical delays and capacity shortages and finance that expansion, but really to allocate the existing space more efficiently and use market forces for that purpose.

I know these are complicated ideas, and I know the amount of time for the overview remarks is limited, so I'll conclude there but say that I think the issue, of whether telling DOT to be more active amounts to re-regulation, is addressed in the report that was mandated—the Transportation Research Board—by the Congress on entry and competition in the airline industry. It brought together some of the best minds. And there were a lot of differences of views there, but the one thing there was absolute consensus on—and I'd like to just read it:

> The Committee unanimously believes that DOT's strategic role should be positive, fostering market-placed conditions that are conducive to entry and more competition.

So, in that sense, again, I endorse the objectives of the bill. I think they are right on, in terms of the impediments and the problems in the functioning of competition. And I think some focus on some of the details to ensure they're truly pro-competitive and inducing the more strategic pro-competitive policies that DOT should be pursuing is really an important step forward.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Hecker follows:]

PREPARED STATEMENT OF JAYETTA Z. HECKER, DIRECTOR, PHYSICAL INFRASTRUCTURE ISSUES, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Committee:

We appreciate the opportunity to testify on some of the vexing issues of competition in the commercial aviation industry. Extensive research and the experience of millions of Americans underscore the benefits that have flowed to most consumers from the 1978 deregulation of the airline industry, including dramatic reductions in fares and expansion of service. These benefits are largely attributable to increased competition—by the entry of both new airlines into the industry and established airlines into new markets. At the same time, however, airline deregulation has not benefited everyone; some communities—particularly small and medium-sized communities in the East and upper Midwest—have suffered from relatively high airfares and a loss of service due in part to a lack of competition.

During the past 12 months, four major U.S. passenger airlines have announced proposed mergers and acquisitions. In May 2000, United Airlines (United) proposed to acquire US Airways and divest part of those assets to create a new airline called DC Air. More recently, American Airlines (American) has proposed to purchase Trans World Airlines (TWA) along with certain assets from United.[1] The potential shifts in industry structure that would result from the proposed mergers represent a crossroads for the structure of the airline industry and the state of competition and industry performance. These proposals have raised public policy questions about how such consolidation within the airline industry could affect competition in general and consumers and small communities in particular.

The Congress has long been concerned about ensuring that the airline industry remains vibrant and competitive. The bill now before the committee—The Aviation Competition Restoration Act (S. 415)—expresses that concern by focusing on airline market concentration. The bill would require the Department of Transportation (DOT) to assert its authority in analyzing and overseeing competition in the airline industry. It would generally prohibit airlines from merging or acquiring the assets of another airline if the resulting carrier met certain tests of market strength and the Secretary of Transportation determined that the acquisition would substantially lessen competition or result in unreasonable industry concentration or excessive

market domination, unless the merging airlines were willing to surrender gates, facilities, and other airport access to smaller carriers. The bill would also require the Secretary to investigate the assignment and usage of gates, facilities, and other assets by airlines that have dominant market positions at large airports. The bill would then have the Secretary require those airlines to surrender gates and other airport assets upon request of another airline or the Secretary's own motion if gates and other assets are not available and competition would be enhanced.

GAO has analyzed aviation competition issues since enactment of the Airline Deregulation Act. Last month, we testified before this committee on how the proposed consolidation in the industry might affect competition.[2] In December 2000, we issued a report on the potential effects of the proposed merger between United Airlines (United) and US Airways.[3] Our statement today is based on those products, earlier work on airline competition issues, and additional analyses of competition at key large U.S. airports. We will: (1) present an overview of the status of airline competition in markets to and from key large airports, (2) summarize federal oversight and enforcement of competition in the industry, and (3) provide some broad observations on the proposed legislation.

In summary:

• Major airlines dominated 16 of the 31 largest U.S. airports (i.e., the airlines carried more than 50 percent of the passengers), at which about 260 million passengers traveled in 1999. Moreover, these dominant airlines faced relatively little competition; another airline competed (i.e., carried more than 10 percent of the passenger traffic) at only 6 of the 16 dominated large airports. Low-fare airlines such as AirTran Airlines (AirTran) competed at just 3 of those 16 airports. Dominance at an airport, in and of itself, is not anticompetitive. Nevertheless, research has consistently shown that dominated airports tend to have higher airfares than airports that have more competition from other airlines. DOT reported earlier this year that passengers at 10 airports paid on average 41 percent more than do their counterparts flying in markets where the dominant airline faces low-fare competition. In addition, dominant carriers often have exclusive access to essential facilities at airports as well as sales and marketing practices which combine to limit the ability of new or existing airlines to enter markets and compete with them.

• DOT generally has not taken enforcement action against airlines for alleged anticompetitive behavior concerning airline mergers and predatory practices. This includes the period during the 1980s when DOT approved a wave of mergers, such as TWA's acquisition of Ozark, as well as more recently with respect to its authority to prohibit unfair method of competition such as predatory practices. While DOT is not required to proactively take action to ensure or enhance competition, it has taken some actions more recently to enhance competition (e.g. using its authority to grant more slots to new entrants). In the past 3 years, the Department of Justice (DOJ) has twice brought lawsuits against airlines under its authority to enforce the federal antitrust laws.

• GAO and others have repeatedly found problems with fares, service, and access which the proposed legislation would address. While we have not reviewed the proposed legislation in detail, we agree with the intent of the legislation—i.e., to direct DOT to play an affirmative, activist and pro-competitive oversight role in airline competition. However, we have some concerns that the proposed legislation may be more prescriptive than necessary, with the result that the intended results may not be achieved and that some adverse unintended consequences might result. For example, it is not clear that the forced divestiture of airport facilities would necessarily result in real price competition in high-value markets because the new competitor may or may not have a cost advantage relative to the incumbent dominant airline. In addition, we are also concerned that forcing dominant airlines to provide access to other airlines at larger U.S. airports could result in the reduction of service to smaller communities. Finally, while the proposed legislation would make clear that Congress intends DOT to actively pursue investigations of potentially unfair competition, DOT may need additional resources to carry out the legislative intent.

BACKGROUND

The U.S. air transportation structure is dominated by "hub-and-spoke" networks. Since the deregulation of U.S. commercial aviation in 1978, nearly all major carriers have developed such networks. By bringing passengers from a large number of cities to one central location and redistributing these passengers to their intended destinations, an airline's fleet can serve more cities than it could through direct "point-to-point" service. Hub-and-spoke systems provide travelers with more departure and arrival choices and generally allow the airlines to use their airplanes and other equipment more efficiently. Airline networks generally have several hub cities. For

example, Northwest has hubs in Minneapolis, Detroit, and Memphis, and American has hubs in Chicago, Dallas, and Miami.

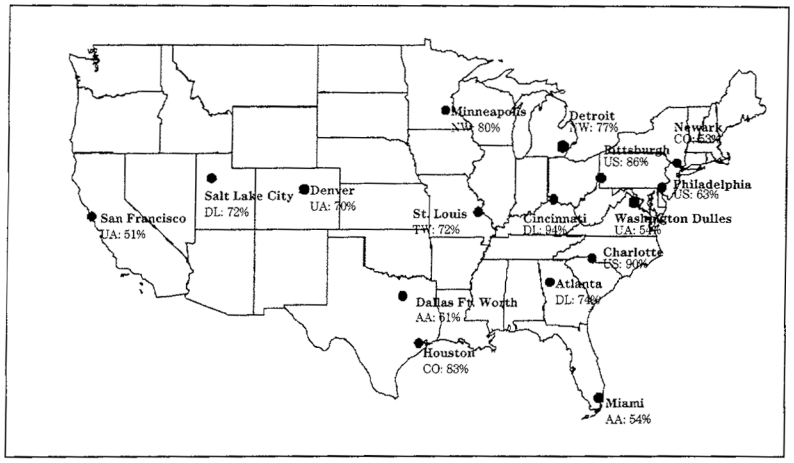
As we recently reported to this committee, if both the United-US Airways merger and American-TWA acquisition are consummated, new United would have the largest market share of any U.S. carrier—over 27 percent—and new American would have a 22.6-percent share. Each proposal could have both harmful and beneficial effects on consumers. The United and American proposals would each reduce competition in approximately 300 markets, with each affecting over 10 million passengers.[4] While the mergers would also each create new competitors in some markets and provide other benefits to consumers, substantial questions remain about how the profound structural changes would affect industry performance. These include the three issues we discussed with the committee last month: how a more consolidated industry might further raise barriers to market entry by new airlines, how the two merged airlines might compete in key markets, and how service to small communities might be affected.

Both DOJ and DOT have responsibilities for reviewing airline business practices. DOJ has the authority to institute judicial proceedings under the Clayton Act if it determines that a merger or acquisition may substantially lessen competition in a relevant market or if it tends to create a monopoly. DOJ also has the responsibility to enforce the Sherman Act, which prohibits unreasonable restraints of trade and attempts to establish and maintain monopoly power. DOT has authority to prohibit airline practices as unfair methods of competition if they violate antitrust principles, even if the practices do not constitute monopolization and attempted monopolization under the Sherman Act.[5]

MAJOR AIRLINES DOMINATE A MAJORITY OF LARGE AIRPORTS

Major airlines dominated a majority of the 31 largest U.S. airports in which approximately 470 million passengers traveled in 1999.[6] Our analysis indicates that major airlines dominated 16 of those "large hub" airports, in which about 260 million passengers traveled.[7] Moreover, these dominant airlines faced relatively little competition.[8] At 9 of those 16 airports, the second largest airline carried less than 10 percent of passenger traffic. Only at Atlanta, Salt Lake City, and St. Louis did a low-fare airline such as AirTran or Southwest Airlines (Southwest) carry 10 percent or more of passenger traffic.[9] Figure 1 shows the large hub airports dominated by each of the major US airlines, along with the market share of the dominant airline.

Figure 1: Dominated Large Hubs Airports



Legend: AA = American Airlines; CO = Continental Airlines; DL = Delta Air Lines; NW = Northwest Airlines; TW = Trans World Airlines; UA = United Airlines; US = US Airways.

Source: GAO analysis of data from BACK Aviation Solutions.

Notably, some of the country's very largest airports are not dominated by any single airline. These include Los Angeles International, New York LaGuardia, and Chicago O'Hare International. In addition, four major airlines—Alaska, America West,

Southwest, and American Trans Air—dominate no large hub airport. Table 1 shows the large hub airports dominated by each of the major US airlines and the total (1999) enplaned passengers for the hubs of each carrier. Appendix I lists each of the 31 large hub airports and shows the percentage of passenger enplanements held by the two airlines that carried the most passengers there.

Table 1.—Airline Dominance at Large Hub Airports

Airline	Dominated large hubs	Total passengers enplaned (1999)
American	Dallas/Ft. Worth, Miami	44,636,299
Continental	Newark, Houston Bush Intercontinental	31,791,401
Delta	Atlanta, Cincinnati, Salt Lake City	57,881,013
Northwest	Detroit, Minneapolis	32,332,669
TWA	St. Louis	14,831,699
United	Denver, Washington Dulles, San Francisco	46,235,863
US Airways	Charlotte, Philadelphia, Pittsburgh	31,946,837
Total		259,655,781

Source: GAO's analysis of data from the Federal Aviation Administration and BACK Aviation Solutions.

Should the proposed merger between United and US Airways occur, along with American's proposed acquisition of TWA, the dominance of the major airlines at these airports would increase. For example, the addition of US Airways' relatively small market share at Chicago O'Hare International Airport would then allow new United to control more than half of the scheduled domestic seating capacity there. New United's share of scheduled domestic seating capacity at Philadelphia would increase from 66.4 percent (US Airways' share of currently-scheduled capacity) to 72.8 percent. New American's share of scheduled domestic seating capacity at Washington's Reagan National would increase from its existing 12.1 percent to 36.6 percent of total scheduled seats; new United's share of scheduled domestic seating capacity at Reagan National would be 23.2 percent.[10]

Evidence of Market Power at Hubs—Higher Fares and Barriers to Entry

An airline's dominance of an airport alone, however, does not demonstrate its market power. One important indicator of the possible exercise of market power is what is known as a "hub premium," which represents the extent to which fares to and from hub cities are higher than average fares on similar routes throughout the domestic route system. Dominated airports tend to have markets with higher airfares than airports that have more competition from other airlines.[11] In 1999, the Transportation Research Board (TRB) confirmed that dominated hub markets (i.e., markets where either the origin or the destination is a dominated hub) tend to have higher airfares than other markets. This is especially true in short-haul markets.[12]

In January 2001, DOT concluded that high fares at dominated hub airports result, in large part, from the market power exercised by network carriers at their hubs.[13] Based on a comparison of fares at 10 dominated hub airports, DOT estimated that 24.7 million passengers in hub markets with no low-fare competitor paid on average 41 percent more than those flying in hub markets with low-fare competitors. Passengers in short-haul hub markets (750 miles or less) without a low-fare carrier on average pay even more. DOT concluded that the lack of price competition, and not other factors such as a concentration of high-fare business travelers, resulted in these higher prices. DOT reported that Cincinnati, Pittsburgh, Minneapolis, and Charlotte—four of the six hubs with the highest market shares of dominated carriers—have the highest overall fare differentials. (See Table 2.) DOT's report further observed that spoke communities may also be subject to higher fares when hub dominant carriers are the predominant service carriers at the spoke communities. Passengers on these routes are charged higher fares because they too do not benefit from aggressive price competition.

Table 2.—Fare Differentials at Dominated Hub Markets

Dominated hub	Percent difference in airfares: routes without low-fare competition vs. routes with low-fare competition		
	Short-haul markets [In percent]	Long-haul markets [In percent]	All markets [In percent]
Cincinnati	78%	35%	57%
Pittsburgh	86	18	57
Minneapolis	46	63	55
Charlotte	75	23	54
St. Louis	38	61	49
Memphis	57	29	43
Atlanta	49	28	41
Detroit	51	21	40
Denver	37	28	29
Salt Lake City	-6	6	2
All	54%	31%	41%

Note: These fare differentials were derived by comparing fares at dominated hub markets in which low-fare competition exists against fares at dominated hub markets in which no low-fare competition exists. All fare comparisons were controlled for distance and density.

It is important to focus on competition and possible pricing premiums in city-pair markets rather than the hub overall, since the existence of large hubs and the presence of low-fare competitors are not mutually exclusive. For example, in 3 of the 31 large hub airports (Baltimore, Las Vegas, and San Diego), Southwest carried the largest percentage of passenger traffic; in another four of the 31 large hubs, it carried the second largest percentage of passengers. Other low-fare airlines compete in some city-pair markets with the dominant airline in dominated hubs. In those markets, travelers experience lower airfares brought about by the presence of low-fare competition. Table 3 illustrates selected markets in which dominant airlines face competition from low-fare airlines with markets of similar distance in which the dominant airline faces no low-fare competition. For example, passengers traveling from Philadelphia to Atlanta appear to benefit from AirTran's competition against US Airways, which charged nearly the same average airfare in 2000. But passengers paid an average of $110 more to fly basically the same distance on US Airways from Philadelphia to Chicago, a market in which no low-fare competition exists.

Table 3.—Comparison of Selected Hub Markets in Which Dominant Airline Faces Low-Fare Competition With Those in Which No Low-Fare Competition Exists.

Origin	Destination	Distance	Passengers per day (one way)	[1]Average fare (airline)
Atlanta	Boston	945	1,130	$104.67 (AirTran) $153.85 (Delta)
	Providence	902	82	$207.05 (Delta)
Dallas	[2]Chicago	795	576	$137.11 (American Trans Air) $177.28 (American)
	Indianapolis	756	135	$254.04 (American)
Denver	Omaha	470	225	$141.95 (Frontier) $171.30 (United)
	Oklahoma City	493	79	$244.46 (United)
Detroit	Tampa	985	549	$103.92 (Spirit) $130.77 (Northwest)
	Dallas	981	434	$234.56 (Northwest)
[3]Houston	Baltimore	1,232	392	$141.10 (Southwest) $215.01 (Continental)
	Pittsburgh	1,124	117	$328.20 (Continental)
Philadelphia	Atlanta	666	1,164	$92.71 (AirTran) $105.64 (US Airways)
	[4]Chicago	676	910	$216.18 (US Airways)

[1] Data for passengers and fares are for the period from the fourth quarter of 1999 to the 3rd quarter of 2000.

[2] Fares and passenger totals shown are for ATA and American's service to Chicago's Midway Airport. American carried most of its Dallas—Chicago passengers to O'Hare International Airport, for an average fare of $280.70.

[3] Fares and passenger totals shown are for Southwest's service from Houston's Hobby Airport and for Continental's service from Houston's Bush Intercontinental Airport.

[4] Fares and passenger totals shown are for US Airways' service to Chicago's O'Hare International Airport.

Source: GAO's analysis of data from BACK Aviation Solutions.

The other way dominant carriers may exercise market power is to employ operating and marketing barriers to limit the ability of airlines to enter and compete in new markets. Figure 2 lists the wide range of operating and marketing barriers available to the large dominant network carriers for either deterring entry into their dominated markets or for reducing the competitive threat from new or existing carriers. A difficult issue to decide is whether exercising these barriers or operating practices represents vigorous competition or anticompetitive practices.

Figure 2: Operating and Marketing Barriers Which Constrain New Entry into Dominated Markets

Access to airport facilities, such as
- Gates
- Ticket counters
- Baggage handling and storage
- Take-off and landing slots

Frequent flyer programs
Corporate incentive agreements
Travel agent commission overrides
Flight frequency
Network size and breadth

In 1999, we reported that competition in certain key airports continued to be inhibited by slot controls, federal and local perimeter rules, and lack of access to facilities.[14] Airfares at these airports, including Pittsburgh and Reagan Washington National, were consistently higher than at airports of comparable size without constraints. Previously, new airlines (i.e., those that began operations after the deregulation of the industry) reported difficulty gaining competitive access to gates at six airports—Charlotte, Cincinnati, Detroit, Minneapolis, Newark, and Pittsburgh. Although some of these airports now have a limited number of gates available, the vast majority of gates continue to be leased to one established airline. Airport and airline officials also told us that factors other than restrictive gate leases, such as the marketing strategies of incumbent airlines, prevented new entrants from providing service at their airports. These marketing strategies, combined with a new entrant's fear of perceived predatory conduct by the incumbent carrier and its possible lack of adequate capitalization, can deter airlines from entering dominated markets.

Airline sales and marketing practices (such as frequent flyer programs, travel agent commission overrides, or corporate incentive agreements[15]) make it difficult for potential competitors to enter markets dominated by established airlines. As we have previously reported, the dominant carrier in each market uses these strategies to attract the most profitable segment of the industry—business travelers. Since the strength of these programs depends largely on the incumbent airline's route networks, alliances, and hubs, new entry carriers who lack such tools are concerned about their ability to enter the market successfully. Therefore, airlines in many cases have chosen not to enter, or to quickly exit, markets where they did not believe they could overcome the combined effect of these strategies. This is particularly true given that, to attract new customers, a potential competitor must announce its schedule and fares well in advance of beginning service. Thus, the incumbent is provided an opportunity to adjust its marketing strategies and match the low fares offered by the new competitors.

FEDERAL OVERSIGHT OF COMPETITION IN THE AIRLINE INDUSTRY

Both DOJ and DOT have responsibilities for prohibiting unfair competitive practices but only DOJ has responsibility for taking actions against mergers. Initially, DOT had inherited the Civil Aeronautics Board's antitrust responsibilities. In the 1980s, it approved a wave of mergers, including two—Northwest's acquisition of Republic and TWA's acquisition of Ozark—that DOJ urged it to oppose. Congress sub-

sequently removed DOT's authority for approving airline mergers, giving that responsibility to DOJ.

DOJ's authority to review airline mergers and prohibit anticompetitive behavior comes from the Sherman and Clayton Antitrust Acts and the Hart-Scott-Rodino Act. DOJ exercised this authority in filing a complaint against the Northwest-Continental proposed stock acquisition. Proposed in 1998, this acquisition gave Northwest 51 percent of the voting rights in Continental. In January 2001, DOJ dismissed its lawsuit Northwest divested all but 7 percent of its voting interest in Continental. In a case involving alleged predatory practices that is still pending, DOJ exercised its authority under the Sherman Antitrust Act to prevent monopolization by filing a complaint in 1999 against American Airlines. DOJ alleged that American violated the Sherman Act by attempting to monopolize service out of Dallas-Fort Worth by increasing capacity and reducing fares "well beyond what makes business sense," to drive new competitors, such as Vanguard and Western Pacific airlines, out of the market.

DOT has no current authority to approve mergers, but it does have general authority under 49 USC 41712 to act against what it considers to be an unfair or deceptive practice or an unfair method of competition in air transportation. DOT has used this authority to investigate several complaints of predatory practices by major air carriers against new entrants. Based on these complaints, DOT in April 1998 proposed guidelines that sought to define standards for air carrier conduct. However, DOT did not finalize or implement those guidelines, concluding instead that it should develop standards through a case by case approach.[16] Today, it is unclear the extent to which DOT's authority under section 41712 extends with regard to predatory practices. Because DOT has not yet exercised its authority, the way in which this provision will be interpreted and applied is unclear.

The Wendell H. Ford Aviation Investment and Reform Act for the 21st Century[17] (AIR–21) required certain large and medium hub airports to submit annual competition plans to DOT in order for the airport to receive new federal grants or to impose or increase the passenger facility charge. The plans are to include information on the availability of airport gates and other facilities, gate-use requirements, patterns of air service, financial constraints, and other specific items. Starting in fiscal year 2001, all covered airports are required to have their plans reviewed by the Federal Aviation Administration (FAA) in order to receive Airport Improvement Program (AIP) grants and new authority to levy passenger facility charges.[18] DOT is to review the plans and their implementation to ensure that each covered airport successfully implemented its plan.

PROPOSED LEGISLATION FOCUSES ON SIGNIFICANT IMPEDIMENTS TO COMPETITION

While we have had only limited time to study the proposed legislation, we are nevertheless pleased to provide some broad comments on the intent and a few key provisions. The intent of the Aviation Competition Restoration Act to ensure "competitive access by commercial air carriers to major cities" is clearly sound. The benefits of preserving and enhancing competition in the airline industry to the public are indisputable. The absence of effective access to markets goes to the heart of failures in the functioning of competition in so many markets. Under current law, DOT has the authority to take action against anticompetitive practices, but it is not required to take any action. The proposed legislation would expressly require DOT to act. We fully concur with the finding that "public concern about the importance of air transportation . . . and continued hub domination requires the Department of Transportation to assert its authority in analyzing proposed transactions among air carriers that affect consumers." Moreover, as noted in the bill's findings, many of the other concerns of the public and Congress regarding the airline industry—increasing flight delays and cancellations, overscheduling, and poor service—are linked to weaknesses in the functioning of competition.

We do, however, have some concerns that the proposed bill may be too prescriptive—and either may not result in the intended effect or produce unintended adverse effects. These comments relate primarily to the provisions of Section 3 which may be more specific than necessary in specifying solutions to potentially anti-competitive effects of proposed mergers[19]—when in practice both problems and solutions could vary from airport to airport, market to market, and carrier to carrier. Below are two examples of these concerns:

• *Forced divestiture of airport "assets" may not necessarily result in real price competition in high-value business markets.* Fares may fall only in markets where competition is effectively introduced from a low-fare carrier rather than another network carrier. Were another network carrier to enter against an incumbent dominant airline, it may offer little if any price competition. The new competing network car-

rier may or may not have a cost advantage relative to the incumbent dominant airline. Moreover, an airline may be reluctant to enter or cut prices in a market where its rival has a large market share for fear that the rival would retaliate by cutting prices in markets where it has a large share—a practice known as "mutual forbearance." For new entrant airlines, access to an airport through its slots, gates, and facilities is necessary but not sufficient as dominant incumbent airlines' sales and marketing practices may make competitive entry difficult if not impossible.

• *Service to small communities could likely be the first casualty of forced divestiture of critical assets.* Depending upon how intensively the dominant airline uses its gates and other facilities at an airport, a requirement that they surrender such assets could negatively affect the airline's ability to maintain service to its spoke communities. Airlines forced to reduce service would be expected to eliminate flights to and from communities that provide the least profit—likely smaller communities. Based on the pattern of service provided by low-cost airlines such as Frontier, Spirit, and JetBlue, each of which generally fly only to larger communities, there is no guarantee that new entrant low-fare carriers would choose to serve smaller markets abandoned by incumbent airlines. Similarly, other network carriers that might initiate service at the hub would also be unlikely to use that facility to begin service to routes they could more profitably serve from their own hubs. However, if dominant airlines could increase the frequency with which they use their gates, facilities, and other assets, service to smaller communities may be little affected.

Other provisions of the proposed legislation appear to provide clear direction regarding DOT actions to exercise its current authority to preserve and enhance industry competition. Section 4 requires DOT to undertake a review of access in the nation's 35 largest airports and authorizes the Secretary to require carriers to provide access at reasonable rates. Section 6 conditions approval of AIP funds and approval of Passenger Facility Charges on an airport sponsor assuring open access to the airport. We have expressed concern about restrictions on access to essential airport facilities functioning as an important barrier to entry. As early as 1996 we recommended that DOT be actively aware of airport and airline practices at the major airports and condition approval of AIP funds on appropriate remedies being instituted. Thus, we fully support the intent of these provisions. Again, however, the specific language might be clarified to focus more on the intended result. For example, AIR 21 already requires the Secretary to ensure "that gates and other facilities are made available at costs that are fair and reasonable to air carriers at covered airports where a "majority-in-interest clause" of a contract or other agreement or arrangement inhibits the ability of the local airport authority to provide or build new gates or other facilities" (Section 155(d)). Potentially there may be more value in calling for a status report on DOT's implementation of their existing authority.[20]

Overall, we recognize that the proposed legislation seeks to focus DOT's wide discretion under their current authority and direct a more activist role in overseeing, promoting and enhancing competition among carriers, as well as assuring a procompetitive role by airport operators. In this regard, we would suggest that there are a wide range of DOT and FAA policies, resources, tools and practices which affect competition in the airline industry which should be both better understood and more strategically aligned. One prominent area where a clearly anti-competitive "temporary" policy has been perpetuated for decades is DOT's administration of "slots" at high density airports. Another area not addressed in the proposed legislation is DOT's inaction to fully investigate and remedy persistent charges of predatory actions by major network carriers to the entry by low cost carriers in their dominated markets in a timely manner.

In short, a dramatic shift of emphasis, commitment and resources is required for DOT to fully address their existing authority and responsibility for protecting and preserving competition in the airline industry. The proposed legislation makes clear many of the key areas where DOT could and should be present in overseeing and enforcing principles of fair competition. The legislation would underscore Congressional intent for an activist oversight role. The major remaining gap—whether or not the proposed legislation becomes law—is the adequacy of resources and technical capacity within DOT to fulfill this vital role. Over the past several years, DOT has lost considerable expertise in airline competition issues due to staff attrition. This expertise needs to be replenished if DOT is to undertake an assertive role in overseeing airline competition. For example, DOT's ability to pursue investigations of potentially unfair competition is constrained by the limited available resources in the Office of the Assistant General Counsel for Aviation Enforcement and Proceedings and the Office of the Assistant Secretary for Aviation Affairs. Perhaps one way for the committee to promote an activist role by DOT could be to require the Secretary of Transportation to make an immediate assessment of the resources available and required to fulfill their existing responsibilities under old Section 411

and AIR 21, the resources needed to implement the proposed legislation, and to develop a strategic plan for meeting these responsibilities.

CONCLUSIONS

The major network carriers dominate traffic at most of their large hubs and there is extensive evidence that fares in markets where competition is absent are consistently above competitive levels. We believe that the oversight scheme contemplated when the industry was deregulated—with antitrust enforcement by the DOJ and oversight of unfair trade practices by DOT—has not been entirely successful in preserving and assuring the functioning of competition. In particular, while the current legislative scheme grants explicit authority for DOT to regulate unfair competitive practices, the legislation does leave substantial discretion with DOT on the scope of their action, if any. Thus, with the range of competitive challenges confronting the industry and directly affecting consumers, especially in the face of unprecedented industry consolidation, we believe there is merit in the overall intent of the bill to direct DOT to actively monitor the state of competition in the industry, and to institute remedial actions as appropriate—both through recommendations to DOJ as well as actions on their own—and all with open reporting to the Congress and the public.

This concludes my statement. I would be pleased to answer any questions you or other Members of the Committee might have.

Appendix I

Large Hub Airports and Airlines That Carried the Largest Percentage of Passengers Carried (Market Share), 4th Quarter 1999 Through 3rd Quarter 2000

Hub	Largest airline	Market share	Second largest airline	Market share	Total passengers[1]
Atlanta	Delta	74.3	Air Tran	10.3	37,606,932
Chicago O'Hare	United	49.7	American	33.1	34,418,016
Los Angeles Int'l	United	28.9	American	16.0	30,436,893
Dallas/Ft. Worth	American	60.7	Delta	18.8	28,074,665
San Francisco	United	51.4	American	10.5	19,262,805
Denver	United	69.5	Frontier	8.0	18,148,611
Detroit	Northwest	77.0	Southwest	3.4	16,910,175
Newark	Continental	53.3	Delta	9.0	16,794,443
Miami	American	53.5	Delta	10.2	16,561,634
Phoenix	America West	41.1	Southwest	30.8	16,316,300
Las Vegas	Southwest	32.8	America West	17.2	15,630,979
Minneapolis	Northwest	79.5	Sun Country	4.5	15,422,494
New York Kennedy	American	24.3	Delta	20.3	15,244,975
Houston Bush Intercon.	Continental	83.0	American	3.8	14,996,958
St. Louis	Trans World	71.7	Southwest	14.9	14,831,699
Orlando	Delta	29.4	US Airways	14.3	13,780,567
Seattle	Alaska	30.8	United	14.5	13,377,182
Boston	Delta	24.4	US Airways	20.4	13,090,336
New York LaGuardia	Delta	26.4	US Airways	19.8	11,769,143
Philadelphia	US Airways	63.4	Delta	7.6	11,711,796
Cincinnati	Delta	94.3	Northwest	2.9	10,801,642
Charlotte	US Airways	90.0	American	1.6	10,754,284
Honolulu	Hawaiian	32.9	Aloha	29.5	10,611,794
Pittsburgh	US Airways	85.8	Delta	3.5	9,480,757
Salt Lake City	Delta	71.7	Southwest	13.4	9,472,439
Washington Dulles	United	54.4	US Airways	14.4	8,824,447
Baltimore	Southwest	38.3	US Airways	26.4	8,316,697
San Diego	Southwest	35.3	United	15.3	7,550,495
Tampa	Delta	21.4	Southwest	19.7	7,348,044
Reagan National	US Airways	32.4	Delta	19.7	7,277,596
Fort Lauderdale	Delta	27.1	US Airways	15.6	6,858,842
Total					**471,683,640**

[1] Data for total passengers represent passenger enplanements (i.e., passengers boarding an aircraft). Thus, for example, a passenger that must make a single connection between his or her origin and destination counts as two enplaned passengers because he or she boarded two separate flights.

Source: GAO's analysis of data from the Federal Aviation Administration and BACK Aviation Solutions.

ENDNOTES

1. Technically, American has proposed to acquire the assets of TWA, which declared bankruptcy. For presentation purposes in this statement, however, we will refer to the transaction as a merger.

2. *Airline Competition: Issues Raised by Consolidation Proposals* (GAO–01–370T, Feb. 1, 2001).

3. *Aviation Competition: Issues Related to the Proposed United Airlines—US Airways Merger* (GAO–01–212, Dec. 15, 2000). See the list of related GAO products attached to this statement.

4. To prepare the GAO products containing this information, we analyzed the most recent data available from DOT on the top 5,000 city-pair markets, which covered calendar year 1999. We recognize that competition or service in particular markets is likely to change over time with the entry or exit of different carriers. Carriers may add or reduce service in markets. These data illustrate the approximate orders of magnitude of the various transactions. We did not subtract passengers or markets that may be affected by DC Air markets or the proposed agreement between United and American to share the current US Airways shuttle from the data for new United.

5. 49 USC 41712 (section 411 of the now-repealed Federal Aviation Act).

6. Consistent with definitions that others (i.e., the Transportation Research Board) have applied in the past, we define an airport as "dominated" if a single airline carries more than half of the total passenger boardings or enplanements. Similarly, an airline would be defined as a "dominant airline" if it carried more than half of total passenger enplanements. "Passenger enplanements" represent the total number of passengers boarding an aircraft. Thus, for example, a passenger that must make a single connection between his or her origin and destination counts as two enplaned passengers because he or she boarded two separate flights. Data for the total number of passenger enplanements in these airports is for calendar year 1999, the latest data available from the Federal Aviation Administration.

7. "Large hub" airports are those defined in the US Code as having at least 1 percent of total annual passenger enplanements. Those hubs are not necessarily the same airports as those which airlines may identify as hubs within their networks ("airline hubs"). Of the 31 large hub airports, airlines label 21 as airline hubs. Each of the 16 large hubs that we identified above are dominated by the airline that runs its network hubs at those locations.

We calculated each airline's share of passenger traffic at each of the large hub airports using data from BACK Aviation Solutions. These data covered four quarters from the 4th quarter of 1999 through the 3rd quarter of 2000—the most recent data available at the time of our work. We confirmed each airline's dominance at these airports by examining current data on airline schedules from the Kiehl-Hendrickson Group. Those data reveal the total number of seats available for purchase by passengers on each airline, including their smaller code-sharing regional affiliates.

8. As in our previous work and consistent with definitions applied by DOT and others, we define a competitor as an airline that carries at least 10 percent of total passenger traffic.

9. Other airlines that DOT defines as being low-fare carriers include American Trans Air, Frontier, National, Spirit, Sun Country, Tower, and Vanguard.

10. New American's market share of Reagan National's capacity includes an estimate of the seating capacity that DC Air would hold (because of American's proposed equity partnership and planned marketing agreement with DC Air) along with half of the capacity of US Airways' Washington-New York-Boston shuttle operations, which it would obtain under an agreement with United. New United's market share of Reagan National's capacity includes its existing capacity with that of US Airways, adjusting for US Airways' divestiture of assets to DC Air and the agreement to split US Airways' shuttle operations with American.

11. Several studies, including our own, have found that airfares in dominated city-pair hub markets are higher than those in markets with competition, when controlling for factors such as distance and traffic density. See for example *Airline Competition: Higher Fares and Less Competition Continue at Concentrated Airports* (GAO/RCED–93–171, July 1993). That report defined concentrated airports as one where an airline handled at least 60 percent of the enplaning passengers or two airlines handled at least 85 percent of the enplaning passengers. We concluded that these fares at these airports were generally higher than at airports with more competition. See also Severin Borenstein, *The Evolution of U.S. Airline Competition*, Journal of Economic Perspectives, Vol. 6, No. 2, Spring 1992). Borenstein concluded that hub-and-spoke networks are not just a source of increased production efficiency,

but that they are also associated with airport concentration and dominance of a hub airport by one or occasionally two airlines.

12. *Special Report 255 Entry and Competition in the U.S. Airline Industry: Issues and Opportunities*, Transportation Research Board, July 1999.

13. *Domestic Aviation Competition Series: Dominated Hub Fares* (US Department of Transportation, Office of the Assistant Secretary for Aviation and International Affairs, January 2001).

14. *Airline Deregulation: Changes in Airfares, Service Quality, and Barriers to Entry*, GAO/RCED–99–92, March 4, 1999.

15. Under frequent flier programs, passengers qualify for awards by flying a certain number of miles with the sponsoring airline. A travel agent commission override is a special bonus commission paid by airlines to travel agents or agencies as a reward for booking a targeted proportion of passengers on their airline. Corporate incentive agreements represent offers by airlines to corporate clients for fares that are discounted from the prices that are otherwise applicable. They may be stated as percentage discounts from specified published fares.

16. DOT reported in January that its review of the TRB report on the proposed guidelines, along with additional analyses, confirmed that airlines engage at times in unfair competitive practices designed to eliminate or reduce competition and that it should take action to prevent such practices.

17. P.L. 106–181

18. Passenger facility charges, authorized originally in the Aviation Safety and Capacity Expansion Act of 1990, are fees levied by local airports (with the approval of the FAA) on enplaned passengers. The charges may broadly be used to (1) preserve or enhance airport safety, security, or capacity; (2) reduce noise; or (3) enhance airline competition.

19. For example, care would be needed in crafting the final language for the DOT role in reviewing mergers to assure consistency with DOJ's authority under the antitrust laws.

20. For example, the FAA/Office of the Secretary of Transportation Task Force Study on "Airport Business Practices and Their Impact on Airline Competition" (October 1999) already outlined a number of specific measures that were needed to ensure competitive access at major airports, including best practices that they identified for replication by various airports. In addition, the recently required airport competition plans have recently been received in DOT. The Committee may want to consider calling for an update on the 1999 report and the status of specific actions DOT has taken and are underway to assure airports are meeting their obligations to ensure competitive access to airports.

The CHAIRMAN. Thank you. I take your recommendations very seriously, obviously, and I think it's—this hearing was planned before this week, when three startup airlines have declared bankruptcy in the last few days, I think, lending some urgency to this issue.

Mr. Hauenstein.

STATEMENT OF GLEN W. HAUENSTEIN, SENIOR VICE PRESIDENT FOR SCHEDULING, CONTINENTAL AIRLINES

Mr. HAUENSTEIN. Good morning, Mr. Chairman and members of the Committee. I'm Glen Hauenstein, Senior Vice President of Scheduling for Continental Airlines. It's an honor to be here representing my 54,300——

The CHAIRMAN. You need to pull the microphone a little bit closer, please.

Mr. HAUENSTEIN. It is an honor to be here representing my 54,300 colleagues at Continental. All of us at Continental commend this Committee for moving so swiftly on merger legislation.

Let me start my testimony today with a clear statement about Continental's position on these proposed mega-mergers. They are bad, and we oppose them.

As you know from the hearings you've held in this room and from the testimony from the GAO and others, the impact of these

proposed mega-mergers will be felt from one end of the country to the other, hurting consumers, communities, and employees. Should the Department of Justice approve these proposed mergers, further consolidation won't be just predictable, it will be necessary to preserve competition.

We believe the swift introduction of the McCain-Hollings-Dorgan-Grassley bill, and the timely scheduling of this hearing, reflect the fact that Members of the Commerce Committee and others in Congress recognize the dire consequences of the proposed mergers.

However, before I address the substance of S. 415, the Aviation Competition Restoration Act, I do want to expand on my statement that the proposed mega-mergers are bad.

We believe, and our analysis shows, that the proposed mega-mergers of United/US Airways and US Airways/American, if implemented, will create a coordinated duopoly that will control the U.S. domestic market and marginalize smaller carriers, like Continental. For example, if the deal is approved, almost 80 percent of all slots at the four federally constrained slot-regulated airports will be controlled by the duopoly of American and United.

At Washington Reagan and New York La Guardia, where slot controls are likely to remain indefinitely, the two mega airlines will control over 65 percent of all slots. By comparison, Continental currently operates with less then 5 percent of the slots at Washington Reagan and New York La Guardia.

On a broader scale today, each major airline has strengths in specific regions of the country. However, none is overly dominant, and a competitive equilibrium exists. With their proposed mega-mergers, United and American have proposed to divide and conquer the entire U.S. market.

Their MOU makes clear they intend to coordinate their businesses. The immediate result will be two giant carriers that jointly control nearly 50 percent of the U.S. airline market. They will each be 50 percent larger in terms of capacity, traffic, and revenues, than the next-largest non-merged carrier, Delta, and three times as large as Continental.

But that's not all. As my chairman has stated publicly on several occasions, the poor customer service which is characteristic of the current operations of those carriers seeking to merge will look glorious compared to the inevitable service disruptions and even worse customer service that will prevail in a post-merger environment.

Nearly half of U.S. air-travel consumers will suffer while the new duopoly attempts to integrate the disparate operations and disgruntled employees of the separate airlines—no small task, especially for airlines currently unable to manage their own operations.

We continue to believe that Continental may benefit from this consumer dissatisfaction in the short run, as we will offer a welcome alternative to the surly and unreliable service offered by the mega-carriers. However, the truth is, over the long-term, we simply will not be big enough fast enough.

Our analysis indicates it would take nearly 20 years of rapid growth to offer a truly competitive alternative to the giant American and United. We won't be in enough markets with enough planes and enough slots with enough gates and facilities to put a

dent in the market share of the mega-carriers. We simply won't be able to offer effective competition.

The topic of gates and facilities brings me to the substance of the bill. On behalf of my colleagues at Continental, I want to commend Senators McCain, Hollings, Dorgan, and Grassley for introducing this legislation. Continental supports the thrust of this legislation as to mergers and acquisitions because it combines the aviation expertise of the DOT with the antitrust expertise of the DOJ.

We are concerned that the legislation, as drafted, could result in the DOJ and the DOT coming to separate conclusions with regard to the same transaction, but we do agree the DOT ought to have an expanded role in the analysis of the proposed mergers and their impact on competition. The DOT has the information, knowledge, and experience needed and can and should be a significant contributor to the Hart-Scott-Rodino process.

The legislation requires that DOT do an analysis of the impact on competition, concentration, and monopoly powers. That analysis, as well as a detailed and specific list of recommendations as to which gates and facilities at all airports, not just hub airports, ought to be divested in order to preserve competition should be provided to the DOJ for their use in conducting the Hart-Scott-Rodino review. And, as the legislation points out, DOT itself has the authority and the responsibility to manage assets under DOT's control to protect competition.

This legislation is on the right track in setting up a standard, or a level of concentration, after which DOT will review the impact of constrained airports. While DOT should be directed to make specific recommendations to DOJ on divestitures of gates and slots at other airports, DOT should also be required to act decisively to protect competition in those areas uniquely managed by the Department of Transportation, such as slots, international route rights, and government-granted anti-trust immunity of international alliances.

We would suggest strengthening DOT action in this arena by setting a slot concentration level that simply cannot be exceeded as a result of mega-merger, as well as a process to redistribute government slots and gates and facilities necessary to operate those slots.

We would also suggest that, in addition to international route divestures, DOT be directed to determine whether the change in domestic dominance requires that DOT revoke the anti-trust immunity it has previously given to the applicants to fix prices and coordinate schedules internationally.

This merger bill is clearly headed in the right direction, and we look forward to working with the Committee on it.

In closing, I would like to emphasize three points. First, I want to repeat our primary message: these proposed mega-mergers are bad and should not be approved. Should these proposals be approved, however, United and American will each have such vast scale and scope that other U.S. airlines will be unable to offer effective competition to them. Other airlines, like Continental, will be forced to combine, be carved up, or be put out of business by the onslaught brought on by the United and American duopoly.

Second, the McCain-Hollings merger provisions represent a good start at attacking the heart of the problem that will result from the proposed airline consolidation by strengthening DOT's role and taking clear aim at assets critical to competition.

My last and final point is a simple one—time is of the essence. This is not the time to be lulled into a sense of complacency. Even though the April 2nd date has been delayed and several unions have made public their opposition to the proposed mergers, the time to act on legislation that impacts these mergers is now. The merger provisions of this bill require immediate attention and I hope, in this case, that the Committee will maintain the pace it has already begun.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Hauenstein follows:]

PREPARED STATEMENT OF GLEN W. HAUENSTEIN, SENIOR VICE PRESIDENT FOR SCHEDULING, CONTINENTAL AIRLINES

Good morning, Mr. Chairman and Members of the Committee. I am Glen Hauenstein, Senior Vice President of Scheduling for Continental Airlines. It is a pleasure to be here representing the 54,300 employees of Continental.

Thank you for your invitation to discuss the important topic of aviation industry consolidation, and, specifically, the proposed mergers between United Airlines, American Airlines, and US Airways, and the legislation which the esteemed Chairman and Ranking Member of this Committee, along with Senators Dorgan and Grassley, have proposed, the Aviation Competition Restoration Act. As the fifth largest airline in the United States, Continental has a unique perspective on the proposed mergers, the proposed legislation, and the effect these will have on the U.S. aviation system and on the passengers that utilize air travel every day.

My goal today is to explain to the Committee why we at Continental believe that the proposed airline mergers should not be approved. These proposed mega-mergers would harm competition and consumers. Moreover, federal approval of these mergers today would be directly at odds with positions taken by the government just a few months ago when the Department of Justice successfully opposed a much smaller airline acquisition: Northwest's purchase of 51 percent of Continental's voting stock. While I know that it is ultimately the Department of Justice's decision as to the future of the proposed United and American mergers, it is important that everyone be fully briefed and that everyone understand the inevitable outcome if these mergers are permitted to occur. These mega-mergers will be bad for competition and will harm consumers, communities, and employees. For this reason, Continental applauds the actions by this Committee to seek ways to stop the mergers or, at the very least, lessen the detrimental impact on competition.

Continental itself is an airline that emerged from a series of mergers in a very different era and a very different industry structure. Texas International, New York Air, PEOPLExpress and Frontier all merged into what is now Continental Airlines. As a result, Continental went through years of delivering poor service to customers, treating employees poorly and managing its finances poorly (including two bankruptcies). However, in 1995 Continental implemented a sensible plan and motivated its employees to turn things around, and over the past six years things have been very different at Continental. Continental is now recognized as the best major airline in the industry. In fact, over the past five years Continental has won more JD Power and Associates/Frequent Flyer Magazine awards for customer service (this past year taking top honors for both long and short haul flights) than any other airline in history. Just two months ago, Continental was named 2001 Airline of the Year by Air Transport World, the second time Continental's worldwide peers have recognized it in five years. Finally, I am especially proud of the fact that Continental has been ranked in the top half of the past three Fortune magazine lists of the 100 Best Places to Work in America, this year ranking in the top twenty. No other major airline, except Southwest, is even on the list. It is from this perspective that I want to give you my thoughts on what is currently facing the U.S. airline industry and on the legislation that has been proposed.

I. THE AIRLINE INDUSTRY CURRENTLY IS CHARACTERIZED BY A STATE OF COMPETITIVE EQUILIBRIUM

Allow me to describe the current environment within the U.S. airline industry. There is currently a competitive equilibrium among the major airlines in the United States. Major reviews of the airline industry since deregulation have concluded that the major network carriers provide effective competition. Air travel has skyrocketed since deregulation, airfares (adjusted for inflation) have declined and the current system of carriers has been able to offer a wide variety of competitive services. The levels of concentration in the airline industry since deregulation have remained relatively low for a network business. Even after the airline mergers of the 1980's, concentration in the airline industry has stayed below critical levels. While each major airline has strengths in specific regions of the country, none is truly strong in every U.S. region. Thus, national competition has been balanced and effective.

The major carriers can be split into three distinct groups: very large national carriers (the "Big Three"), medium national carriers, and small national carriers. United, American, and Delta make up the very large national carrier group. Each of these three airlines has over 16 percent of domestic system capacity and traffic. They are the largest three airlines in the world. They already have the largest frequent flyer programs and distribution channels, and they control more airport real estate than any other carrier. While the Big Three are considerably larger than the next group of carriers, they provide equilibrium for each other. Moreover, the medium national carriers can remain competitive because their scope and scale disadvantage is not so large that it cannot be at least partially overcome by offering superior service or lower prices compared to the Big Three.

The medium national carrier group consists of Northwest, Continental, Southwest, and US Airways. Each of these carriers maintains between 7 percent and 9 percent of domestic capacity and traffic. These four airlines, while not as large as the Big Three, offer strong competition on a national basis and have found a niche in which they are able to compete. For example, US Airways holds many slots at the four federally slot-controlled airports and has a strong position in the important Northeast region of the country. Southwest competes based on price. Northwest has a strong North Central and Asia market position. Continental competes based on its internationally recognized superior customer service. Each medium sized carrier has found a way to be successful, even though they are about half the size of their larger counterparts.

The final group, small national carriers, consists of TWA, America West, and Alaska. These carriers are each between 2.5 percent and 6 percent of domestic capacity and traffic. While these carriers have found it more difficult to compete against the seven larger airlines, all but TWA have been successful in their regional focus. TWA has historically shown strength at its Midwest hub, while both America West and Alaska have shown similar strengths in the West.

Finally, there are currently a number of successful new entrant/low cost/niche carriers that help in maintaining balance and competition in the airline industry. Airlines such as Midway, Midwest Express, Air Tran, and JetBlue all compete vigorously with larger carriers in a limited number of individual markets.

II. THE PROPOSED MERGERS WILL HARM COMPETITION

Against this backdrop of a competitive environment that is at equilibrium is the proposal of United and American to split up US Airways. This will create an unbalanced competitive environment in which the two resulting mega-carriers are significantly larger than their next largest competitors. Clearly United and American's plan is to reach detente, build a cartel, and carve up and dominate the U.S. air travel market. Look closely at the proposals; they include sharing the Northeast shuttle and sharing the Northeast region between the cartel members. Ultimately, the same way United and American have split Chicago O'Hare and London (Heathrow), they will split the rest of the U.S. (and maybe even split global aviation). The two mega-airlines have even incorporated a provision in their agreement that restricts American's ability to merge with other carriers and puts limits on American's growth. Should American grow faster than United wants it to, United would have the right to terminate the Northeast shuttle agreement the two airlines have proposed. United would also have the right to repurchase certain US Airways assets being divested to American and a right of first refusal for any assets American divests as part of a subsequent transaction. This provision is clearly a horizontal restraint between major competitors. It allows United to restrict American's future growth by acquisition, requires cooperation between United and American on future acquisitions, and has the effect of stabilizing the relative shares of the two largest airlines.

After consolidation, United and American will each be of such vast scale and scope that other U.S. airlines will be unable to offer effective competition against them. The airline industry will change for the worse, adversely affecting competition, consumers, communities and employees. Other airlines will be forced to combine, be carved up, or be put out of business by the onslaught brought on by the United and American cartel.

After the current wave of proposed consolidation, United and American will control nearly 50 percent of the U.S. airline industry and have twice as many hubs as Delta, Northwest, or Continental. The new United will serve one hundred more domestic destinations than its nearest competitor. Additionally, American and United will each become more than 50 percent larger in terms of capacity, traffic, and revenue than the next largest non-merged carrier (Delta), and they will be almost three times as large as Continental. After the mergers, United and American will also be the #1 and #2 airlines in the largest regions with the most revenue and business traffic, the Northeast and West regions. Via the mergers, United and American will have created the only two truly national networks. While other airlines may continue to maintain some regional presence, their ability to compete nationwide will be lost. Consummation of these mergers will allow United and American to ensure that they have eliminated competition on the national (and even on the global) stage. In conjunction with their national presence, the two mega-carriers will have frequent flyer loyalty programs two or three times as large as their nearest competitors and distribution and marketing systems that no other airline will be able to match. The combined effect of this will be to produce a quantum shift in the distribution system that squeezes out other carriers in a manner that has never occurred before.

Finally, the two airlines will operate almost 80 percent of all slots at the four federally slot-controlled airports (Washington Reagan, New York LaGuardia, New York JFK, and Chicago O'Hare). At Washington Reagan, where slot restrictions are expected to remain in place in perpetuity, and at New York LaGuardia, where the FAA has already stopped expansion and slot restrictions are likely to be reinstated, the two airlines will control over 65 percent of all slots. By way of comparison, Continental operates only 3 percent of all slots at the four airports, with less than 5 percent of the slots at Washington Reagan and New York LaGuardia.

In order to compete with the two mega-carriers, other airlines will need to grow to at least a scale that is near that of the market leaders. Independent growth to the scale of United or American will be nearly impossible. An airline like Continental, with just over 8 percent of the current domestic capacity, would need nearly twenty years to grow to the size of United and American even if Continental could grow at a very aggressive average annual rate of 10 percent (2–3 times expected GDP growth) and if the two mega-carriers grew at expected GDP levels of about 4 percent. By comparison, over the past six years Continental has only been able to grow at an average annual rate of just under 5 percent. Hyper-growth of 10 percent annually for Continental is not realistic over the long term.

Slot restrictions at Washington Reagan, New York LaGuardia, New York JFK, and Chicago O'Hare limit growth in major eastern markets. Not only is access to these airports limited, but United and American will hold the keys with their combined 80 percent share of the slots. Additionally, the limitations on the supply of capital, mechanics, pilots, and aircraft, and limitations on the capacity of the air traffic control system, will also impede the ability of airlines to grow at such a hyper-rate for extended periods. More importantly, however, Continental is concerned that faster than historical growth will limit its ability to do what it does best, providing passengers with quality customer service. With hyper-growth, an airline runs a serious risk of spoiling its product, something Continental will not do.

The destruction of the competitive equilibrium that is the obvious and direct result of these proposed mergers means that independent growth to compete with United and American is virtually impossible. Airlines will be left with no choice but to merge in order to compete effectively with the two mega-carriers. Additional airline mergers will be required to restore a competitive playing field to an airline industry that would otherwise be split by the United and American cartel.

III. THE PROPOSED MERGERS WILL HARM CONSUMERS, COMMUNITIES, AND EMPLOYEES

The proposed mergers are clearly bad for consumers. The labor and service disruptions coupled with reduced customer service brought on by the integration of the four merging airline systems will, in the short run, benefit Continental as we attract passengers looking to escape the uncertainty and problems they will experience with the mega-carriers. The service disruptions and customer service complaints of the past few years are nothing compared to what is coming if the proposed mergers are

approved. Think back over the past few years. American has been through pilot and flight attendant slowdowns. United also has been through work slowdowns which created some of the worst operational and customer service problems this industry has ever known, and labor unrest is the story of 2001, aside from the news generated by the proposed mega-mergers. United ranked last in Department of Transportation on-time performance statistics seven times this past year, with an average quarterly on-time performance (in the second and third quarters) of barely 50 percent. Continental, by way of comparison, ranked in the top three each quarter of the year. Continental's on-time performance last summer was better than previous years, and in December we beat our closest competitor by almost seven percentage points in on-time performance. Continental was also the #1 airline in on-time performance for the entire year 2000, out of all major network carriers. And Continental is off to a great start in 2001 as well, finishing #2 in January and #1 in February. With regard to baggage performance, United again had poor performance, finishing each quarter in ninth or tenth place, with statistics at least 25 percent worse than the industry average. And regarding customer complaints, United's record has been so bad that by the third quarter of last year, United's number of complaints per 100,000 enplanements was more than double the industry average. Now think about the same service disruptions and problems aggravated by the incredibly difficult task of integrating four systems, four aircraft fleets, and most importantly four distinct groups of fragmented and hostile workforces into two airlines. While Continental stands to gain in the short run because we offer an attractive alternative to surly and unreliable service, we will simply not be big enough to offer a truly competitive alternative in the long run. The vast majority of passengers will have no choice but to be forced to suffer whatever service, or perhaps more accurately, lack of service, United or American may offer.

The proposed mergers are also bad for communities. According to the General Accounting Office, in its report "Aviation Competition, Issues Related to the Proposed United Airlines-US Airways Merger", released December 2000, 290 markets will have reduced competition or have competition eliminated completely because of only this one merger. The report goes on to state that "About 16 million passengers traveled in those 290 markets in 1999 . . ." In a hearing before this very Committee, the GAO reported that "the United and American proposals would each reduce competition in approximately 300 markets, with each affecting over 10 million passengers." As a point of comparison, the Northwest/Continental transaction opposed by the Department of Justice entailed reduced competition in only 63 markets affecting 2 million passengers.

Communities not only will be affected by a loss of competition and deteriorating service, but also could face service cutbacks and route elimination as United and American rationalize their systems. By merging all of the routes each carrier serves from their pre- and post-merger hubs, it is highly likely routes will be eliminated to reduce overlap. While United has given a "commitment" that it will not eliminate routes, this "commitment" is for only two years, does not hold for American, and does not extend to reductions of service on routes short of route elimination.

It is clear that the proposed merger will be bad for consumers and bad for communities. The mergers will also be bad for employees. Unlike Continental, which prides itself on its excellent management-labor relationships and on the fact that it is a great place to work, history has shown that both United and American have different views on how they treat employees. The ramifications of poor labor relations that we have felt over the past few years will be amplified and continue for years to come. Significant labor integration issues have accompanied virtually every major airline merger in the history of our industry, and these proposed mergers would not be exceptions to this rule. As you know, our industry is currently facing significant labor unrest, including problems at the four largest domestic airlines (United, American, Delta, and Northwest). The risk of compounding this turmoil with the labor integration issues of a consolidating industry is massive, and the problems faced by passengers every day are sure to be greatly compounded.

IV. US AIRWAYS HAS OTHER OPTIONS

While it is clear that US Airways will lose a significant amount of money this quarter, and possibly this year, it is simply unclear that any merger is necessary, as US Airways has one of the richest pools of valuable assets in the industry. Their cache of lucrative slots and their Northeast strength cannot be matched. If Continental was able to turn itself around (with its more limited assets yet intensely focused management team) and become the financial and commercial success it is today, there is no reason that US Airways, with the right incentives and appropriate management, utilizing US Airways' crown jewels of assets, cannot do the same. But

if US Airways is determined to sell itself, allowing the airline to be split by United and American is not the only option. Continental made an offer for US Airways' Washington Reagan position that was for a much higher price than the current DC Air/American deal. Continental's offer was turned down, not based on the economics, but based on the fact that it would put a crimp in the cartel's plan. Continental is also very interested in the significant slot and facility holdings of US Airways in New York. These assets were never even offered to anyone except American. Other carriers have also expressed interest in significant portions of US Airways assets, although it is unclear why the carrier feels that it has no choice but to sell itself.

Reports indicate that US Airways may be a failing concern, or soon will be, much in the same way that TWA is being seen as a failing concern. While it is clear that TWA has many problems and probably could not survive on its own, it is equally clear that this is not the case for US Airways. First, US Airways is growing. Its revenue base, year over year (2000 versus 1999) has grown by nearly 8 percent, as has the number of aircraft the airline has in its fleet. System capacity for US Airways (as defined by the available seat miles it offers) has grown by nearly 12 percent. While earnings for the airline have declined (as they have for most U.S. airlines), high fuel prices have been the key driver of reduced profits. US Airways' cash balance has grown to over $1.2 billion, more money than Continental currently has on hand, and clearly a sustainable amount. Finally, US Airways has spent nearly $2 billion over the past three years on a stock buyback program. Companies that are having serious financial problems and that are concerned about their long-term future do not spend their cash buying back their own stock. All of this points to the reality that the "financial concerns" about US Airways are myth, and certainly not reality.

V. THE PROPOSED MERGERS SHOULD BE DISAPPROVED

So what is the answer to the proposed mergers that will create two mega-carriers that have the ability to dominate the market, reduce or eliminate competition and are bad for all constituencies? JUST SAY NO!

The conspiracy by United and American to reach detente, create a duopoly, and control the U.S. domestic market (thereby tightening their stranglehold on foreign markets as well), if implemented, will be so devastating that it should be disapproved outright. The government should stop trying to find fixes to mergers that should not be approved in the first place. And the government needs to clearly understand that it cannot fix, after the fact, the problems these mergers will create.

It is important to note that the Department of Justice prevailed in its antitrust challenge of Northwest's proposed acquisition of 14 percent of Continental's stock (representing a little more than 50 percent of Continental's voting rights). This case was brought to trial notwithstanding the fact that Northwest signed a governance agreement limiting its control of Continental for at least six years. The government brought the case because it believed that Northwest's partial ownership would lessen competition primarily on routes between the six Northwest and Continental mainland U.S. hubs. Today we are faced with the prospect of a combined United/US Airways (10 hubs) and American/US Airways (7 hubs). Consolidation of these carriers would give the combined firms more than 90 percent of the non-stop traffic on the routes between their respective hubs. Moreover, unlike the Continental/Northwest transaction in which Continental and Northwest would have continued to compete, United and American will actually have eliminated their primary competition between those important hubs and have agreed not to compete with one another on some of the most important routes in the world (the Northeast shuttle markets).

While the facts should compel the government to reject the proposed acquisitions, I am not confident that the right thing will be done to protect airline consumers and competition from the United and American duopoly. Because of my skepticism, I must impress upon you that if, against all of the best wisdom, United and American are allowed to move forward with their plans, further airline consolidation is inevitable and will be required to assure effective competition. The U.S. aviation industry will require at least three large national network carriers to recreate the equilibrium that we currently have and that will be lost if United and American are allowed to complete their proposed transactions. Only through the smaller airlines' ability to grow and their ability to further consolidate will competition be possible. Consolidation will be required because, absent legislation to make sure that the assets necessary to compete are available, there will be no other choices.

Congress, the Department of Transportation, and the Department of Justice must together ensure that appropriate slots, gates, and other facilities at slot and capacity constrained airports are made available to smaller network competitors. The legisla-

tion offered by Senators McCain, Hollings, Dorgan, and Grassley, the "Aviation Competition Restoration Act", brings together many of the elements necessary to prevent mega-mergers from wiping out the competition.

Continental supports the thrust of this legislation as to mergers and acquisitions because it combines the aviation expertise of the Department of Transportation with the antitrust expertise of the Department of Justice. Continental agrees that the Department of Transportation must play a more active role in the analysis of the proposed mergers and their impact on competition and consumers. We are encouraged that Secretary Mineta has made a commitment to begin this process. The Department of Transportation has the information, knowledge, and experience needed and can be a worthwhile contributor to the Hart-Scott-Rodino process by providing an analysis of the impact of the proposed mergers on competition, and whether or not the mergers would result in unreasonable industry concentration, excessive market domination, or monopoly powers. The Department of Transportation can and should provide specific recommendations for needed asset divestitures at all airports impacted by mergers. Additionally, the Department of Transportation must act aggressively in areas under its unique jurisdiction - particularly in those areas managed by the Department of Transportation, such as the federally created high density rule slots, international route rights, and antitrust immunity for international alliances. Where the Department of Transportation finds that, in the context of mergers, these Department of Transportation managed assets can and will be used to reduce competition, it must act to protect and defend consumers. Many of these important elements are contained in the proposed legislation.

Continental suggests, however, that the legislation could be strengthened by the addition of specific requirements for the redistribution of federally limited slots and the gates and facilities necessary to operate these slots, when a mega-merger causes the concentration of slots to become so high that it simply will not be possible to adequately compete. We are also concerned that, as drafted, the merger and acquisition section of the proposed legislation would not only require two separate reviews by two different government departments, but that those two departments could come to different and opposite conclusions. Much as we would like to see the proposed mega-mergers disapproved, we believe that each of the two departments should retain primary jurisdiction and its unique areas of expertise. The Department of Justice should continue to be the final arbiter of the antitrust issues, but its should do so taking into account the analysis required under this legislation by the Department of Transportation. The Department of Transportation should be directed to provide specific recommendations for asset divestitures necessary to protect competition. This means that the Department of Transportation should be directed to review all airports (not just hub airports) that are impacted by the mergers to determine whether or not facilities are reasonably available. And in this instance, let me say that special attention must be given to airports such as New York LaGuardia, Washington Reagan, Chicago O'Hare, Boston Logan, Los Angeles International, and San Francisco International, just to name a few! This specific analysis and recommendation should be provided to the Department of Justice for use in their deliberations under Hart-Scott-Rodino.

As to the Department of Transportation, it should have primacy and be required to act in areas under its control and expertise. Therefore, the legislation could be strengthened by setting out the concentration level that would trigger specific and required actions by the Department of Transportation in the areas of slots, international routes, and antitrust immunity for international alliances.

There is no doubt that where there are mergers which result in particularly high levels of system capacity concentration, such as the proposed United and American mega-mergers, there will have to be divestiture of assets at high density airports, most importantly Washington Reagan and New York LaGuardia, airports where federal slot controls are not likely to ever be removed. Slots at these airports should be reallocated to ensure that other carriers, like Continental, have a reasonable chance to compete. In addition, gates, ticket counters, and other required facilities should accompany the reallocation of slots so as to make sure it is possible for the receiving airline to use the slots.

As United and American strengthen their domestic positions, the ability of other U.S. carriers to compete internationally will be reduced. For example, United and American are already the only two airlines with the right under the U.S.-U.K. bilateral to fly into London Heathrow airport, the most important business airport in Europe. United and American's growing control of the domestic market will make this already huge disadvantage to Continental and other U.S. airlines even greater. The U.S. should renew its efforts to negotiate more access to London Heathrow for competitors of the mega-carriers or to negotiate to substitute other carriers at London Heathrow for the two mega-carriers. Additionally, United and American have

a large array of foreign partners with which they have alliances, making their control of world air transport even greater. The ability of small network carriers to offer foreign partners enough scale and scope in the U.S. is limited, and it is clear that given a choice of partnering with a member of the duopoly or partnering with a smaller carrier, foreign airlines will choose the duopoly. As antitrust immunity only exacerbates this problem, I call for a serious re-evaluation and revocation of the antitrust immunity already granted to the mega-carriers and their foreign partners.

VI. HUBS PROVIDE IMPORTANT CONSUMER BENEFITS

Last year, Congress required all airports to develop and implement a plan to guarantee access to the facilities necessary to preserve and protect competition. Many airports have moved quickly to address the capacity issues of concern to this Committee and should be commended for their work in this area. Certainly, the Department of Transportation should survey all airports to determine if there are continued capacity constraints and whether or not the airport has a plan in place to deal with the constraints. The Department of Transportation should report back to the Congress as to the progress that has taken place and outline those airports where improvements are still needed. If the airports are not meeting their obligations under Air–21, the Department of Transportation should withhold federal funding for those airports.

However, Continental is concerned that any action requiring the Department of Transportation to confiscate assets and force divestiture in the absence of a proposed mega-merger could have disastrous unintended consequences. Consumers could be harmed by major reductions in airline service, loss of employment for airline employees, and reductions in service to the very small and medium sized communities the Congress tried to assist last year with the passage of the Air–21 legislation.

Airline hubs do provide important benefits for consumers and allow more passengers more options every day. Hubs allow airlines to serve many more destinations than they would otherwise be able to and allow airlines to create connections across the world. This benefits passengers who have more options than they would have if connecting complexes were not available. Hub airports and consumers could be devastated if the non-merger elements of the proposed legislation are implemented, as airlines are forced to reduce schedules and as the communities these airports serve are faced with a loss of nonstop service. Airline employees could see their opportunities dwindle as the airlines are forced to shrink to meet legislative requirements. And small and medium sized communities will be the first to see a loss of service, as they are usually the thinnest routes an airline operates and therefore would be the first to lose service.

That having been said, Continental understands the need for a study on constraints at airports, but would urge the Committee to refrain from further action, at least until the Department of Transportation study is completed and Congress has had a chance to review the Air–21 provisions already enacted in this area. This, however, must be contrasted with the actions that must be taken quickly to provide competition in the face of the proposed mega-mergers. Tying the hands of those remaining independent carriers who are fighting for their lives will only exacerbate the problem.

VII. CONCLUSION

Mr. Chairman, the time has come for the Government to put a stop to the mega-mergers being proposed by the two largest airlines in the world. I hope that I have helped to explain to you, this Committee, your constituents, and all Americans the dangers that face the U.S. aviation industry should the proposed United/American/US Airways mergers be approved.

While I know that it is not ultimately this Committee's decision as to whether the mega-mergers are allowed to proceed, it is within this Committee's power to ensure that all of the facts are available and that the consequences are known. This Committee has also taken an important first step in discussing the legislative options available, in a small way, to help ensure that competition remains if the mergers are incorrectly allowed to proceed. Continental urges this Committee and the Congress to act quickly, as time is running out. I must also remind you that if these two mega-mergers are permitted, other airlines will be forced to merge, and those mergers will be necessary to restore effective competition. Therefore, if the Department of Justice approves the pending mega-mergers, others will follow and must be approved to permit effective competition.

Mr. Chairman and members of the Committee, I thank you for giving me the opportunity to discuss these very important issues with you and for your attention. I would now be pleased to answer any questions that you may have.

The CHAIRMAN. Thank you very much.

Mr. Neeleman, welcome.

STATEMENT OF DAVID NEELEMAN, CHIEF EXECUTIVE OFFICER, JETBLUE AIRWAYS

Mr. NEELEMAN. Thank you, Chairman McCain.

I appreciate the opportunity to come and speak to you today, and I think it's certainly apropos for this legislation, because JetBlue is nothing more than a living, breathing example of a company, when given access and given the chance to succeed, is—and we never like to count our chickens before they're hatched—but is succeeding. And we're succeeding—we had quite a first year and added 11 brand new jets with 11 new cities, flew 1.1 million passengers, reached profitability after 6 months, and have had five consecutive months of profitability—in the last 5 months.

Senator LOTT. Mr. Neeleman—Mr. Chairman, if you'd yield—I'm not that familiar with your company. Where do you—what area do you serve?

Mr. NEELEMAN. We serve—we're based out of New York, in Queens, and we serve Upstate New York, 13 flights a day—Buffalo, Rochester—we'll begin Syracuse, also serve Burlington, Vermont, and we serve five cities in Florida, as well as—we serve cities—Oakland and Ontario, California, Seattle, Denver.

And so we're basically adding a plane every month, and we have—I think the reason that we're a living, breathing example is that we were granted, under the 1994 FAA re-authorization, 75 takeoff and landing slot exemptions at Kennedy Airport, which was a slot-restricted airport. It was an airport that had really—had gone away from domestic air service, and we saw there was a need for the people in the area there, as well as people in Upstate New York. And so we went to the DOT and they granted us the slots, and we combined new planes, great capitalization, a fantastic management team, and a great employee group, and are currently, today, providing great customer service to our customers.

And that—I think that's the number one factor in——

The CHAIRMAN. You might mention, for the benefit of Senator Lott and others, how you equip your airplanes.

Mr. NEELEMAN. Well, I think—we looked at air travel, and it hadn't changed in the last 40 years, and so we came up with a couple of interesting ideas. And we put, in the back of every single seat, live TV—24 channels of live TV and leather seats.

And so what we found is, by using innovation, using technology, using high utilization of our assets, we found a very loyal customer base that loves flying on JetBlue. They call it the "JetBlue experience."

The CHAIRMAN. You have new airplanes?

Mr. NEELEMAN. And we have brand new airplanes, as well.

And that brings me to the reason that we're here today, and it is to speak in favor of S. 415. You know, we have had success, like I said, bringing—there was no jet service from Kennedy Airport to Buffalo, Rochester, Syracuse, Burlington, Vermont, Fort Meyers,

Oakland, and Ontario—and we have many other cities we're going start the first jet service to this year. But our biggest concern is access to other cities.

As we start working down the coast to the Carolinas, with Senator Hollings, to Virginia—there are a lot of cities there that have pockets of pain—it is very difficult for us to be able to serve these medium-sized markets unless we have feed.

We cannot gain access to Boston, for example. There are no gates available in Boston for us. And, ironically enough, as we've studied the airport and looked at the gate utilization, if we could help reschedule the gates, we could find an abundance of gates. But that's not something that's in the cards for us at this time.

The CHAIRMAN. What you're saying is the major airlines underutilize their gates.

Mr. NEELEMAN. Yes, they do, and I think that's pretty well proven, that they use them—there was examples of these hubs where you have 87 planes land, and they're 35 minutes, then 45 minutes, then they all take off, and then they're vacant for 4 hours and——

But I think, for the most part, particularly in a city like Boston, that is in a major hub, there are gates available, and we need access to those gates. Without access, it would be very difficult for us to serve the medium-sized markets to create, really, a critical mass to be able to fly enough passengers to the Virginia's and to the Carolinas, where we would like to serve but are having difficulty doing because of access to Boston.

We also don't have access to Washington National with slots and/or gates. And if we could do that, we could also serve more cities to the north of New York, as well.

And so I think it's really critically important, as we contemplate these mergers and as we look at what we can do to foster competition—you know, I'm reminded of a statement that I used last time I testified here in Washington last Spring. And it was a comment by the president of the United Airlines, Ronno Dutta. And he said that he sees the day where there will be three or four finished networks, where there will be these carriers, and you'll be able to go from anywhere to anywhere. But he also sees the day there will be a dozen or so thriving regional carriers that will be able to provide service for low fares and good service.

And we agree with him. We just need to make sure that—when the dust settles from these mergers, that we have access. We've proven that if we have access, we will succeed.

And we are strongly in favor of S. 415, because we think that the major purpose of this bill is to grant us access. And we ask for the Senate support on that and thank Chairman McCain for his leadership in making sure that this bill is being heard today.

Thank you very much.

[The prepared statement of Mr. Neeleman follows:]

PREPARED STATEMENT OF DAVID NEELEMAN, CHIEF EXECUTIVE OFFICER, JETBLUE AIRWAYS

Mr. Chairman, Ranking Member Hollings and other distinguished members:

Thank you for the opportunity to again testify before this Committee. Since I was here last June, much in the industry has changed, and unfortunately for the American consumer, much has stayed the same.

This morning I will briefly discuss the changes underway in the U.S. aviation industry and some of the issues that these proposed changes raise for the American consumer and smaller carriers.

JetBlue Airways is *New York's low fare hometown airline*.

We have been flying from New York City, the nation's largest travel market, for more than a year and we have achieved many successes. From our humble start last February with two new jets flying between Buffalo, JFK and Fort Lauderdale, JetBlue now has eleven new jets serving twelve cities with 64 daily flights.

Although JetBlue is a low fare carrier with fares up to 79 percent lower than our competitors, we achieved our first profit after only six months of operating and reported our first profitable quarter at the end of last year. We are on track to continue this financial growth. In our first year JetBlue operated more than 10,000 flights and achieved a 99.2 percent completion factor with an on-time performance of 79 percent, compared to an on-time average of 72 percent for the ten largest carriers. During this inaugural year, JetBlue carried more than 1.1 million customers and achieved a system-wide load factor of 73 percent. Finally, after only ten months, we had flown more than $100 million in revenue.

Our financial performance is a direct result of our dedicated crew of 1,400 and our relentless drive to keep our costs down. We achieve low costs through an industry-leading use of our aircraft, nearly 14 hours per day, and an unprecedented use of technology. JetBlue is proud to be the only carrier in America with a fully electronic FAA manual system, increasing safety and efficiency by enabling our pilots to use their standard issue laptop computer to log on and access the most up to date manuals prior to each and every flight they operate.

While our operating statistics are all far above the industry average, most important for us is the experience, the *JetBlue Experience*, we deliver to our customers. With low fares, leather seats, free in-seat satellite TV with 24 channels and our special brand of friendly service, we only had ten complaints lodged against us with the DOT in our first year of operations, translating to a rate of .66 complaints per 100,000 enplanements, putting JetBlue far ahead every major carrier save Southwest, with whom we were tied for the lead. Further, DOT reports our mishandled bag rate was nearly half that of the major carriers' average rate.

Senators, I suspect that if the six largest carriers in America each offered everyday low fares on all of their routes no matter when a passenger reserved their trip or whether they stayed over a Saturday night, offered comfortable leather seating with plenty of legroom, had very gracious and friendly staff from check-in to the in-flight portion of the trip, brought you your bags on time and operated flights regularly and always in an on-time manner, many of you and most Americans would have very little concern with the pending consolidation of the airline industry.

Unfortunately, the reality is that today's airline industry is far from this picture I have just described. Rather, today's airline industry is perceived as late, uncaring, uncomfortable and expensive. Thus, the thought of strengthening the power and market domination of carriers with this reputation is frightening for many.

I submit that the answer to many of the problems plaguing today's industry is not a re-regulation of the industry or laws governing how big an employee's smile ought to be, but rather the only thing that has ever altered industry behavior in America: the capitalistic cure known as competition.

JetBlue, and others, offer competition. We offer choices. Oftentimes, and in JetBlue's case, these competitive alternatives come with low fares and more reliable service.

Yet, if the aviation business cycle is leading us to three or four major carriers dominating the domestic airline landscape, the government should not be opposed to this consolidation per se, but rather be determined to let the marketplace work itself out through vigorous and fair competition. The role of government, however, should be to ensure that smaller carriers have the opportunity to compete on a level playing field, in particular at constrained facilities where it matters most.

Today, JetBlue stands ready to play its role as a vibrant competitor, but finds that it is being shut out of key airports and thus being denied the opportunity to compete fairly.

Several of you and your colleagues have introduced legislation addressing important issues from how passengers are treated to imposing a moratorium on mergers to insuring access to key facilities in a post-consolidation era.

JetBlue strongly supports S. 414, the Aviation Competition Restoration Act, introduced by Senators Hollings and McCain. This bill, particularly Section 4, requires the Secretary to investigate the use of gates and facilities at the 35 largest airports and determine whether they are being fully utilized, whether they are available for competitors and whether they should be reassigned to non-dominant carriers in order to improve competition. Following such an investigation, the Secretary would

be required to make such facilities available to an applicant airline on a fair, reasonable and nondiscriminatory basis. While other carriers have had difficulty obtaining access to numerous airports, JetBlue has been effectively locked out of two airports important to New Yorkers, both Boston's Logan and Washington's Reagan National.

Of the top 1,000 passenger markets in the United States, the Boston-New York market is the third largest and the Washington-New York market is the fifth largest. These two short-haul markets, while very large today, sustain their strength despite the high average one-way fare of more 60 cents per mile in the Washington market and nearly 80 cents per mile in the Boston market, due to the total absence of any low far service. Imagine how much commerce and leisure traffic would be stimulated with JetBlue's everyday low fares to and from New York's JFK. In fact, fifteen years ago when there was low fare competition these two markets had two million more passengers than they do now.

Today, there simply is not a level playing field and thus, clearly viable new entrant carriers like JetBlue cannot enter these critical markets. In Boston, we are told there are no gates. In Washington, we are told there are no slots.

If the Department of Justice, after its deliberations, determines the pending deals present no violations from an antitrust perspective, then it is up to the Department of Transportation to review the competitive impacts of the proposals. S. 415 guarantees that the Secretary of Transportation will in fact investigate, and upon application, remedy any lessening of competition on non-discriminatory terms. JetBlue certainly expects that the bill's intent in using the term "non-discriminatory" is to make sure non-dominant carriers pay no more for facilities than the carrier that presently has them paid for such facilities.

This key provision of S. 415 is precisely why it the bill is so important. It allows the marketplace to work itself out fairly, with no special treatment for the largest carriers or the smallest carriers. If a large carrier paid X amount for a gate, so too should the smallest carrier that obtains the gate under this bill. If a large carrier received a publicly owned landing or take-off slot at no cost, so too should a smaller carrier under S. 415.

In this light, JetBlue has strong reservations about one key provision of the bill that reportedly will be introduced by Senators DeWine and Kohl. In their bill, carriers with more than 15 percent of domestic available seat miles would be prohibited from owning or operating more than 20 percent of the slots at LaGuardia or National Airport in any two-hour period. While this is a positive step in the right direction as it recognizes the unacceptable level of dominance at key facilities, their proposed solution to preventing such concentration appears not to be aimed at ensuring competitive access by smaller, low fare carriers but rather to ensure parity among the three major carriers not involved in the pending mergers. Their bill would redistribute the slots through a blind auction where the richest bidders would surely obtain the slots, thus maintaining the status quo of limited or no new, low fare competition. Such high bidding, as would likely continue under the DeWine-Kohl bill, has been widely used to create the present system and effectively block new entry. This, as the General Accounting Office and Department of Transportation have observed, is the key reason that the 1986 buy-sell rule has failed to achieve its goal of fostering competition by new entrants in key markets.

As we were not in existence in 1986 when slots were given to carriers at no cost, JetBlue's very existence is in part a result of the 1994 FAA Reauthorization law which created slot exemptions at all High Density Rule airports, save Washington's National. JetBlue applied for and received the right to use, or lose, up to 75 slot exemptions at JFK during that airports' five-hour slot period by the end of a three-year term. Senators, using these slots we are.

While we cannot, by law, sell, trade, lease or collateralize these public assets as other carriers can and do, JetBlue has used its slots to bring low fares to markets with either no service, high fare service or both. In just our first year, JetBlue introduced the only nonstop jet service between New York's JFK and both Rochester and Buffalo, New York, with Syracuse to begin this Spring, Burlington, Vermont, Ontario and Oakland, California and Fort Meyers, Florida. All of our slot exemptions have brought unprecedented levels of fare reductions and traffic stimulation to each market we serve.

JetBlue's slot exemptions represent an initiative taken by Congress and implemented by the Department of Transportation, which has proven that a level playing field for new competitors can have a dramatic impact. Senators, S. 415 also represents a moderate and measured step to letting the marketplace pursue its natural course while ensuring that, especially in key markets, new competitors, if interested, are assured they can enter and compete.

I will conclude in the manner I did last Spring when I reminded the Committee of a prediction made by the President of United Airlines: Ron Dutta envisioned the day when only a few large carriers with finished networks would exist in the U.S. along side a dozen or so regional carriers. His prediction, in part, is proving true in a quicker manner than I suspect he even realized.

If this Congress watches as the Government approves the pending consolidation that creates these finished network carriers, and does nothing to ensure that the other regional carriers are able to compete fairly, then the worst fears about the pending deals which I alluded to earlier will certainly materialize.

Thank you for the opportunity to come before this Committee.

The CHAIRMAN. Thank you, Mr. Neeleman, and congratulations. Mr. Kahan.

STATEMENT OF MARK KAHAN, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, SPIRIT AIR LINES

Mr. KAHAN. Thank you, Mr. Chairman. It has been, I think—it's been five times that I've been before you, and I always begin my oral remarks by reminding myself, if nobody else, that I came to Washington 24 years ago with Fred Kahn, my mentor, to deregulate the airline industry. It is the—certainly, it is the professional capstone of my career, and it's something that I'm very proud of, very concerned about. I think that almost everybody agrees that we are at a critical moment in the process of deregulation. And I'm, as always, honored to be here to speak to the Committee.

Before I get into the meat of the problems, I would want to spend just a minute or so just going over a few good signs, because I think that this hearing shouldn't be all gloom. There are some good things. The year 2000 had AIR–21 and some other things. The idea that a carrier would get 75 slots to begin its new entry was really unthinkable 5 years ago. In fact, I remember filing a wonderful application—well-supported application for 10 slots to fly between Detroit City Airport and New York, and it was denied by the Department of Transportation in a totally different climate. And I think the Committee's efforts have been instrumental in changing that climate.

Likewise, in 2000, our two gates at Detroit, after 10 years wait, finally became operational, and our 500,000 passengers that we serviced last year are beginning to get the service they deserve. Likewise, as a direct result of this Committee's efforts, we began service to Chicago in late 2000. I'm pleased to say that by January, with a limited number of slots, we carried 30,000 passengers from O'Hare.

Now, we're at the international terminal—there are times of the day when we can't operate—so we wouldn't be able to compete with the business carriers, even if we wanted to. And we pay customs and immigrations fees for passengers who are flying from places like Fort Lauderdale and Myrtle Beach to and from Chicago. So our situation is not perfect, but I think that the Committee and, you, Mr. Chairman, in terms of our service to DCA, that just wouldn't have been possible without your efforts. So we, at Spirit, think there has been some progress made, and we think the Committee should be commended for its efforts.

Of course, if all were rosy, we would not be sitting here today. With the proposed mergers before us, the long-predicted concentration we've discussed so many times of the country's merger airlines into, at most, three entities covering 80 percent or more of the na-

tional market has moved from a reasonable prediction to a substantial probability.

Now, I've always believed the goal of competition policy, whether expressed through legislation or through the executive branch, should always be to protect and promote competition, not individual competitors. If a company, like TWA, has been through two bankruptcies and has been unable to earn a profit for a decade or longer, public policy should not prevent it from exiting the market.

Likewise, it's not really unreasonable for the management of a high-cost carrier to look for a way out in the interest of its shareholders and employees when it's losing market share.

So there's nothing personal about this. I want to focus in on some of the policies, some of the regulations, which have made this possible and which I believe is fueling the merger wave.

What is unreasonable is not that carrier managements want to merge, but that the management of a high-cost carrier might expect a merger solution that will result in a very, very large stock premium primarily because the purchaser will gain control of congested airports through public assets that the acquired carrier previously obtained without charge.

Now, one of the things that S. 415, which I support, shines a light on, without out quite saying so, is the buy/sell rule. This was promulgated in 1986. The way to avoid some of the regulation in S. 415, as Senator Hutchison would like to do, is to take a close look at that regulation. I think all of us should agree that if there are regulations on the books that are outmoded, they should be sunset-ed rather than fueling a merger wave.

Here's the problem. The value of slots to carriers who are seeking to protect existing operations or thwart new entry will always be greater than their intrinsic value to a new entrant who must offer lower competitive fares to penetrate the market.

Since incumbent carriers also have the biggest checkbooks, there is no contest as to who gets access in these situations. And, not surprisingly, concentration at the major airports in the country has increased. I'd point out that it's not just the question of mergers. If there was no merger, and TWA and U.S. Air, God forbid, were to simply liquidate through the bankruptcy auction process, the competitive result would be much the same.

And so I think that as long as buy/sell is on the books, the DOT authority provided for in S. 415 is vital, and it's vital in principle, in any event. But if somebody doesn't like that particular regulation, they should look at the buy/sell rule very closely. And I urge the Committee to ask the Department of Transportation and the FAA to look at that and to sunset it.

S. 415 also shines light on another problem which is fueling the merger wave. There really is a gap in Federal legislation relating to control of gates. Control of gates has always been viewed as appropriately local. S. 415 deals, in my opinion, effectively, although I hope in the course of its consideration to offer some suggestions for improvement for the gate problem when we're in the presence of mergers or where there is a very dominated hub—more than 50 percent. OK? I believe that DOT should have effective tools to deal with airport concentration issues on a regular basis and not only in those particular situations.

I think that all gate transactions that increase concentrations should be within DOT's discretionary authority, and I believe that refusals to deal by "have" carriers should be presumptively labeled as unfair and exclusionary practices.

Now, I take the point that, better than introducing legislation, public policy ought to try to increase the availability of resources and the efficiency with which they are used. And I agree that the NIMBY approach, Not In My Back Yard, is an enemy of progress in the airline industry, just as it is in so many other places that we have to deal with here. But we also have to recognize that there are some Federal policies which, in my opinion, actually create a bias in favor of congestion at airports.

I think that we are effectively subsidizing small airplanes. And, if I can, I'd like to give you one little anecdote to illustrate my point. I recall sitting in the jump seat of one of our MD–80's last November while we sat immobile on a taxiway waiting to cross some other taxiways to get to our gate 150 yards away.

And in the 45 minutes that we sat waiting—and this was at the height of the chaos at La Guardia—I did some calculations as to how much our passengers were effectively paying in infrastructure-related costs and how much the passengers of the ten turboprops and regional jets that were parading past us were paying. And I calculated that our passengers were paying a minimum of $2100 for infrastructure-related costs and that the smaller planes were paying $600.

Now, I'm not saying that there's not a good place for small planes. I think that they do have a very, very important place. But I also believe that in order to harmonize our goals, in terms of providing small community service, but at the same time avoiding gridlock at airports, we have to look seriously at pricing. All right?

Basically, infrastructure cost right now are the excise tax, the segment fee, and wait-based landing fees, but you have to recognize that at a congested airport, the relevant cost, the asset that we're allocating, is time—runway time—and there's no difference in the costs between those imposed by a large airplane and a small airplane. And I know it's going to be very difficult to look at that kind of stuff, but unless we start to look at that stuff seriously, we're going to have some trouble.

In closing, I'd like to comment on DOT's role, which is expanded by this legislation. S. 415, is to some degree self executing and to some degree requires considerable administrative discretion by the department.

Now, the previous administration did ask many of the right questions with respect to the State of aviation competition, and it sought to move in the right direction. At the same time, DOT was hampered by a lack of resources and expertise, and it did drop the ball on some issues entirely.

My mentor, Fred Kahn, taught me one fundamental rule—regulate only if necessary; but if you must regulate, regulate well. His declared intention to bring more rigor into the DOT's competitive analysis and recommendations to the Department of Justice are welcome.

It is my hope that this Committee, along with the relevant appropriations committees, will take the steps necessary to ensure that the secretary's goal becomes reality.

Thank you, sir, and I'll be happy to answer your questions.

[The prepared statement of Mr. Kahan follows:]

PREPARED STATEMENT OF MARK KAHAN, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, SPIRIT AIR LINES

Chairman McCain, Senator Hollings, and Members of the Committee:

It has been almost five years since my first appearance on behalf of Spirit Airlines before this Committee to discuss competition in the airline industry, and the nation's successes and failures as the deregulation process has unfolded. I am honored to be here again today in support of the Aviation Competition Restoration Act, because it addresses many of the dangerous trends we have observed over those years. As Professor Michael Levine testified before you on Feb 1, 2001, the deregulation process is at a critical point.

First, Spirit Airlines would like to recognize the Committee's efforts over these last five years in promoting airline competition. In 1997, when I first testified here, no branch of government had a good understanding of the potential for predatory behavior in this industry, its tendencies toward concentration, or the intractability of its barriers to new entry. In 1997, Spirit had just finished a very difficult year. In 1996, Spirit was driven by its major hub competitor from the Detroit-Boston and Detroit-Philadelphia markets. We had no gates in Detroit and little prospect for obtaining them. Spirit had no access whatsoever to the High Density airports.

There has been progress in a number of areas. Last year, we carried almost 3 million passengers and our 1950 dedicated employees saved passengers in excess of $300 million. Our two gates in Detroit became fully operational last year and serviced almost 500,000 of those passengers. In 2000 as well, as a direct result of this Committee's efforts, Spirit began service to Chicago's O'Hare airport. That service has been well received and, in just two days, will be expanded to include Myrtle Beach, South Carolina. We began a very limited service from Reagan National Airport, which would have been completely impossible without the Chairman's efforts. And in New York City, a subleased gate became available at Newark and Air 21 slots became available at LaGuardia, permitting service throughout the day from both airports.

Spirit's progress has not always been smooth and we have encountered bumpy air from time to time. Our operations remain intensely constrained by a scarcity of facilities and slots at key airports. There are many examples, which I would be pleased to share with you and your staff. But much of Spirit's growth would have been impossible without this Committee's efforts and your continuous oversight has helped the public understand that airline deregulation cannot succeed unless barriers to entry are addressed by an intelligent public policy.

Of course, if all were rosy, we would not be sitting here today. One theme has been constant in every hearing over these past years—the airline industry is concentrating to alarming levels. Far more carriers continue to exit the market than enter it, even without mergers. Although I believe that S. 415 can be improved in some ways as it goes through the legislative process, its fundamental premises are correct. S. 415 recognizes that barriers to entry and exclusionary conduct remain constant concerns and that concentration of the industry's real estate (gates) and its airspace (slots) in a few dominant carriers precludes truly competitive outcomes. With the proposed mergers of American and TWA, and United and US Airways (with American's participation), the long predicted concentration of the country's major airlines, covering 80 percent or more of the entire national marketplace, toward three principal entities, has moved from a reasonable prediction to a substantial probability.

A second and related theme at each hearing is that we must seriously address congestion in the infrastructure supporting the airline industry if deregulation is to succeed. In 2000, congestion issues came to a head as DOT, despite good intentions, implemented Air 21 without sufficient regard for practicality. This led to total gridlock at LaGuardia airport, creating enormous problems for us and the travelling public.

Before addressing what needs to be done, however, a caution is in order about what we should not do. The goal of competition policy, whether expressed through legislation or the executive branch, should always be to promote and protect competition, not competitors. We say this often, but cannot overemphasize it. If a company has been through two bankruptcies and has been unable to earn a profit for

a decade or longer, public policy should not prevent it from exiting the market. In fact, the marketplace is distorted when well-intentioned policy makers take actions designed solely to prop up such a carrier—such as conferring two free slots from DCA to Los Angeles when that same carrier is already selling or leasing to other carriers the vast majority of slots it long ago received for free. Likewise, it is not totally unreasonable for the management of an extremely high cost carrier, which is steadily losing market share to others, to look for a way out in the interests of its shareholders and employees.

What is unreasonable is for the management of a high cost carrier to expect a merger solution that will result in a 100 percent stock premium primarily because the purchaser will gain control of congested airports through public assets that the acquired carrier previously obtained without charge. To the extent that the impetus for either of these mergers flows from monopoly power arising from conglomeration of public assets, government intervention such as that envisioned under S. 415 is certainly appropriate. Anti-trust analysis and remedies are important but not sufficient.

This legislation shines the spotlight on several problems that must be addressed. First, 15 years after it was issued, it is time to recognize that the "Buy-Sell" slot rule (14 CFR 93.221) has retarded rather than promoted competition. It is a major facilitator of both current mergers and a problem all by itself; even if the carriers left the market in the traditional manner, i.e., through bankruptcy and liquidation, the competitive outcome would be much the same because the resulting auction would see the airport assets likely going to the same incumbents.

The value of slots to carriers who are seeking to protect existing operations or thwart new entry will always be greater than their intrinsic value to a new entrant who must offer lower, competitive fares to penetrate the market. Since incumbent carriers also have the biggest checkbooks, there is no contest as to who gets access in these situations and, not surprisingly, concentration at slot controlled airports has steadily increased. Along with passage of S. 415, Congress should require DOT and FAA to take a hard look at this regulation and sunset it. And, for much the same reasons, I believe the Committee will be highly disappointed if an auction turns out to be the principal tool of slot allocation.

Second, there is a gap in federal law relating to gates at congested or hub airports. Control over gates has always been viewed as appropriately local. Neither Anti-discrimination provisions in the FAA's authorizing statutes, nor competitive impact requirements in PFC (passenger facility charge) administration, have provided effective tools to avoid concentration of scarce airport gates in the hands of a few dominant carriers. There is also considerable doubt that DOT's jurisdiction over unfair and competitive practices reaches these kinds of situations. DOT should have effective tools to deal with airport concentration issues on a regular basis and not only in the crisis of a proposed mega-merger or where there is extreme hub dominance. 49 U.S.C. 41712 could be amended to bring all gate transactions that increase concentration within DOT's discretionary authority. Refusals to deal by "have" carriers should be presumptively labeled as unfair and exclusionary practices.

Public policy that increases the availability of resources and the efficiency with which they are used is far superior to prescriptive regulation that merely deals with the negative effects of scarcity. We need to address the underlying problems of airport and airway congestion, which not only lead to these competitive distortions but also, as we are all aware, have seriously degraded service to the flying public in recent years. Before we can think in terms of congestion pricing, which, in principle, I wholeheartedly support, we must recognize that the current bias in airport pricing effectively subsidizes small airplanes. Current airport pricing practices, some of which are embedded in legislation, actively promote congestion. This is not, as popularly thought, a simple political struggle between the airlines and general aviation. This bias infects airline scheduling in a major way.

I recall sitting in the jump seat of one of Spirit's 164 seat MD–80s while we sat immobile on a LaGuardia taxiway waiting to cross some other taxiways and enter the alley where our gate is located. This was in November, at the height of the chaos. Before we could make a move, a parade of 10 turbo props and regional jets had to taxi by and clear the area. Recognizing that current "user charges" for airport facilities are basically the excise tax/segment fee and a weight-based landing charge, I did some basic arithmetic during the 45 minutes our 164 passengers waited to move the 150 yards to the gate. I concluded that our MD–80 passengers were contributing a minimum of $2100 to infrastructure costs while the commuter passengers were paying, at most, about $600. Consider, however, that there is little or no difference in infrastructure costs imposed by varying sizes of aircraft; the primary resource to be allocated is runway space and time and, if anything, smaller

and slower planes impose more costs than larger aircraft. It follows that, at least at congested airports, a rational pricing system would assess infrastructure fees on a per plane basis. The only quick way to increase airport capacity is to encourage the use of larger aircraft and the discouraging truth is that we currently do the opposite.

In closing, I'd like to comment on DOT's role. S. 415 is to some degree self-executing and to some degree requires considerable administrative discretion by the Department. The previous Administration asked many of the right questions with respect to the state of aviation competition, increased the understanding of predatory pricing, and sought to move in the right direction. At the same time, DOT was hampered by a lack of resources and expertise. It dropped the ball entirely on some issues, such as CRS and the use of new entrant proprietary data by mega-carrier marketing departments. We at Spirit are heartened by the President's decision to name an experienced and effective aviation legislator as Secretary. My mentor, Alfred Kahn, taught me one fundamental rule: regulate only if necessary, but if you must regulate, regulate well. Secretary Mineta has his work cut out for him. His declared intention to bring more rigor into the DOT's competitive analysis and recommendations to the Department of Justice are welcome. S. 415, the Aviation Competition Restoration Act, will not work well unless the Executive Branch is capable of doing its share. It is my hope that this Committee, along with the relevant Appropriations Committees, will take the steps necessary to ensure that the Secretary's intention becomes a reality.

Mr. Chairman, I will be pleased to answer any questions from the Committee or to provide any additional information that may be helpful.

The CHAIRMAN. Thank you very much.

Dr. Cooper, welcome back.

STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Dr. COOPER. Thank you, Mr. Chairman. I'm glad to be back, and I'm going to deliver roughly the same message I delivered last week when we addressed a different issue, and that is a pro-competitive message, and I might out that—start by pointing out to Senator Burns that the Consumer Federation of—and myself, personally—are original members of the Competitive Rail Access Coalition from 15 years ago, and we believe in that pro-competitive access. And that's what this statute is about, and we'll be glad to support you when you move your legislation in the sister network transportation industry.

With the introduction of the Aviation Competition Restoration Act, the public-policy debate over the airline industry and its deregulation has entered a new phase. It is none too soon. With four of the largest airlines proposing to merge and several other major mergers being discussed, the airline industry is organizing itself into a private cartel—you've heard that described—that will be disciplined neither by market forces, nor by regulation, and that is unacceptable.

A few dominant airlines will control the vast majority of traffic through monopoly airports in fortress regions—we've now moved from fortress hubs to fortress regions—that are imbedded in national networks that rarely compete. They will bump into each other at an end point here and there, but everybody else in between will be captive. The ability of new entrants to crack these markets will be further reduced, as you've heard today, because it becomes harder and harder to attract passengers on flight segments, and the scale of entry necessary becomes larger and larger.

At the core of this structure is a system of fortress airports defended by anti-competitive practices. Incumbent airlines create bar-

riers to entry by locking in customers and locking out competitors, denying access to facilities and engaging in predatory pricing. It should come as no surprise that the result of these anti-competitive practices are higher prices and lower quality endured by the public.

As demonstrated in dozens of studies—and I've been adding these to the list, and the list gets longer and longer every time I come up and testify—it is quite clear that competition among numerous airlines lowers prices and increases output. The cost savings we have seen in study after study is between 20 and 50 percent for each additional competitor. And this is true whether competition is measured and analyzed by the entry and exit of individual carriers on individual market segments or at the level of general concentration ratios.

Whenever the industry is confronted with this overwhelming evidence, it tries to divert your attention back to that 20-year-old debate about whether or not to deregulate this industry and whether or not we have benefited. It seeks to hamstring policymakers' ability to address specific problems by saying any form of intervention is a return to price and quality regulation.

The simple fact of the matter is that deregulation is more than 21 years old. The industry is mature. It has grown up, and it has to take responsibility for its own anti-competitive actions. There's inadequate competition in the industry. It is abusing consumers, and it is time to act.

The Aviation Competition Restoration Act is exactly the kind of response we need. It is a well-crafted, pro-consumer, pro-competitive approach to reintroducing competition in the industry to discipline its abuse. It is not re-regulation of prices and quantities.

The logic of these measures is impeccable. Concentration of traffic through hub and spoke networks, which was unanticipated when we deregulated this industry—and I hate to date myself, but I was in town when we had that debate—was unanticipated. No one saw hub and spoke. It's an efficient way to organize the industry. The airlines found that out.

But concentration of ownership and control of slots has been mistaken with concentration of traffic. We do not have to have complete dominant control of 90 percent of the traffic in an airport to concentrate it there at critical times. It was never necessary to have both forms of concentration.

By opening up half the slots at fortress hubs, new entrants will be able to compete for the flow of traffic. At the same time, by allowing firms to dominate 50 percent of the traffic at the major airports, they will still have an interest in concentrating the flows there. And that is the kind of solution we need.

The competitive access provisions of the Aviation Competition Restoration Act are a form of interconnection requirement to ensure fair access to choke points in this network industry. The Consumer Federation of America and Consumers Union have vigorously supported exactly this type of competitive access across a range of industries—railroads, electronics, computers, telecommunications. In a network world, which is where we live, access to the choke points is critical to ensure competition.

We commend you for taking this approach, for understanding the nature of these industries, and we look forward to working with you to ensure that we restore competition in this industry.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Dr. Cooper.

[The prepared statement of Dr. Cooper follows:]

PREPARED STATEMENT OF DR. MARK N. COOPER, DIRECTOR OF RESEARCH, CONSUMER FEDERATION OF AMERICA

Mr. Chairman and Members of the Committee, On behalf of the Consumer Federation Of America[1] and Consumers Union,[2] I commend Senators Hollings and McCain for introducing the Aviation Competition Restoration Act and urge speedy enactment of this bill as a critical first step in bringing more competition to the airline industry. The legislation could help to crack open the dominance of major airlines at fortress hubs and expand consumer protection by restoring real competition in the industry, which is the form of competition we prefer.

A couple of years ago I published a paper entitled Freeing Public Policy From The Deregulation Debate: The Airline Industry Comes Of Age (And Should Be Held Accountable For Its Anticompetitive Behavior).[3] Since then this industry has experienced a dramatic decline in the quality of service, a dramatic increase in prices, and now stands on the verge of a merger wave that will make matters worse. Not only is it time for the industry to bear responsibility for its own actions, it is time for policymakers to confront the reality that this industry is not and will not be organized on a vigorously competitive basis.

CONGRESSIONAL ACTION IS NECESSARY TO PROTECT THE FLYING PUBLIC FROM THE ABUSE OF MARKET POWER IN THE AIRLINE INDUSTRY

With the introduction of the *Aviation Competition Restoration Act,* the public policy debate over deregulation has entered a new phase. It is none too soon. From the consumer point of view, the intense, ideological debate over deregulation that has taken place in this country over the past three decades has had a major, negative impact. Instead of crafting careful public policies that promote competition while restricting the abuse of market power, regulators have been largely immobilized by a fruitless debate over what would have happened under continued regulation as compared to what did happen with deregulation.

At one end of the spectrum, advocates of deregulation refuse to accept the fact that problems arise, for fear that such an admission will be used to convince policymakers that reregulation should be tried. At the other end of the spectrum, the advocates of regulation refuse to acknowledge that efficiency improvements flow from deregulation, for fear that such an admission will be used to prevent policy makers from addressing the specific problems that arise. What gets lost in the middle is good public policy. The pure efficiency gains that have clearly been made as a result of deregulation have been polluted by rampant abuse of market power. The performance of the deregulated industries certainly improved, but not nearly as much as it could have from the consumer point of view or should have from the public policy point of view.

With the two pending major airline mergers and a third being widely talked about, there can be no more uncertainty about the structure of the industry. The airline industry is in the process of organizing itself into a private cartel. The three dominant firms will control the vast majority of traffic through monopoly airports in fortress regions embedded in national networks that rarely, if ever, compete with one another. A few end points will have vigorous competition, but the vast majority of passengers will be trapped on routes with far too few alternatives to create an effectively competitive market.

As travelers fall more and more under the control of one airline, the ability of new entrants to crack markets is reduced, as it become harder and harder to attract passengers to flight segments. The necessary scale of entry gets larger and larger. The inconvenience and, in many cases, the impossibility of inter-airline travel, give the originating airline enhanced market power over the traveler and makes it more and more difficult for smaller airlines to compete for the traffic.

Market power results in higher prices wherever it exists and miserable service. Since the major airlines do not face effective competition, they do not feel compelled to improve quality. Thus the future debate should not be about whether to return to the old-school, price and quantity regulation of the middle of the century, but

about how policy can increase public welfare by promoting competition and preventing anti-competitive actions.

The *Aviation Competition Restoration Act* embodies two of several essential steps necessary to rebuilding the competitive base of the airline industry and protecting the public from the abuse of market power by the airlines. The critical elements contained in the proposed legislation are (1) to empower an agency to take a hard look at the overall industry structure in reviewing merger activity and (2) to empower the Department of Transportation to crack open the fortress hubs where there is a demonstrated interest in entry or new airlines.

Ultimately, at least two other steps would be needed: (3) an anti-predation rule that prevents dominant incumbent airlines from snuffing out entrants with predatory practices and (4) a consumer bill of rights, since it will take significant time for the procompetitive measures to function and there are many markets in which too few airlines will exist to compete to meet consumers' travel needs. While we note the other things that must be done, CFA and CU believe that the measures in the *Airline Competition Restoration Act* would be an enormous step in the right direction. To appreciate why this is exactly the right place to start, we must review the nature of the failure of competition in the airline industry.

ANTICONSUMER EFFECTS OF A WEAK COMPETITION

At the heart of the market power wielded so brutally by the major airlines is a system of fortress hubs and the anticompetitive, predatory practices that major airlines use to prevent new entrants from serving the fortress hubs. As these fortress hubs grow into fortress regions, the prospects for new entrants will shrink into nonexistence, unless Congress takes action.

The empirical evidence that the creation of fortress hubs raises price is overwhelmingly clear. It should come as no surprise to you that dozens of studies show that competition among numerous airlines leads to lower prices and higher output. This is true no matter how competition is measured. The effect is observable at the micro level in the form of the entry of individual airlines into specific markets and at the macro level in the form of generalized concentration ratios.[4] Econometric studies of market structure have consistently shown that concentration on routes, at airports, and in the industry at large are associated with higher fares (see Exhibit 1).

Flowing from this evidence, we find support for a number of traditional observations about public policy. Actual competition is vastly more important than the threat of competition.[5] Barriers to entry play a critical role in determining the level and nature of competition.[6] Analysis of specific events—entry, exit and mergers—confirms these findings. Mergers tend to reduce competition, increase prices and lower output.[7]

Estimates of the general impact of competition on price are on a similar order of magnitude. Several GAO and DOT studies have found that prices are 20–50 percent lower in competitive markets. Similarly, estimates of the elimination or addition of one competitor bolster these findings. The impact of a low cost competitor is particularly pronounced. When specific low cost carriers are identified, like People's or Southwest, fares often are 35 to 40 percent lower than in markets without such aggressive new entrants. Thus, having one additional competitor impacts prices by 20 to 50 percent.

The econometric and anecdotal evidence is supported by a general trend in prices (see Exhibit 2). Airfares, as measured by the consumer price index have increased dramatically, particularly when key components of airline costs are taken into account. Since the mid–1980s, fuel prices have dropped by almost 50 percent. The cost of capital (measured by AAA corporate bonds) has declined by 20 percent. These are two of the three largest costs for airlines. Yet, airfares have mounted steadily.

FORTRESS HUBS

The centerpiece of industry structure in the deregulated environment—the hub and spoke network—is a constant source of public policy concern. Advocates of deregulation failed to anticipate the development of this form of industrial organization.[8]

While they may have recognized the possibility that competition would not develop on lightly traveled routes or at small airports,[9] the notion that single airlines would come to dominate and control huge airports as fortress hubs was unthinkable twenty years ago. As a result, there has been a vigorous effort to understand why the industry has organized itself in this way.

Part of the complexity of the analysis stems from the fact that the characteristics of hubs that appear to confer market power are both "positive" and negative. Just

as competition can create efficiencies so too can hub and spoke networks. The key characteristics include economies of scale and operating efficiencies, as well as marketing advantages that make it extremely difficult for competitors to enter. The concentration of traffic at hubs allows incumbents to achieve lower costs.[10] The concentration of traffic and prominent position in the hub enables the incumbent to achieve both a greater reputation and to offer a broader range of options at the hub.[11] Advertising and promotion are facilitated.[12] Scheduling and baggage handling are better coordinated.[13]

Unfortunately, the story does not stop with these positive aspects of industry organization. In practice these "positive" economic advantages of hub and spoke networks have been immediately leveraged with anti-competitive actions to increase and exploit market power by incumbents dominating hubs. Incumbent airlines create barriers to entry by locking in customers and disadvantaging competitors in a variety of ways. Traffic is diverted to the dominant incumbent hubs through a number of marketing mechanisms that extends market power over travelers frequent flier programs,[14] deals with travel agents to divert traffic,[15] manipulation of computerized reservation systems,[16] and code sharing.[17] The ability of competitors to enter hubs is undermined in a number of ways. Access to facilities is impeded through a number of mechanisms that preclude or raise the cost of entry,[18] including denial of gate space,[19] extraction of excess profits on facilities,[20] and efforts to prevent entrants from attracting adequate passengers to establish a presence.[21]

As a result, consumers do not see any of the savings from hubs. Instead, they endure higher prices and are treated badly. This finding cannot be overemphasized, especially in light of recent efforts by airlines to demonstrate that, in theory,[22] larger networks provide consumer benefits. In practice, as the Department of Justice and a great deal of empirical analysis demonstrates, the theoretical benefits never materialize in reality because the major airlines abuse their market power. Cost savings are not passed through to consumers. When competitors enter concentrated hubs, prices go down and frequency goes up—both in the number of departures and in the number of seats available. This gain occurs not only because the new entrant provides new seats at lower prices, but also because incumbents do too.

When entrants do show up, the dominant airlines have engaged in blatantly predatory pricing to drive them out of the market.[23] The state Attorneys General and the Department of Justice have identified six specific airlines and at least fourteen routes (from major fortress hubs) in which predatory conduct drove competitors from the market. In each case, one of the airlines that is currently proposing to merge was involved in the anti-competitive behavior. The dominant airline cuts its fares and adds capacity when the new entrant shows up. Once the entrant is driven out of the market, capacity is reduced and fares are increased.

Having gained this advantage, the incumbents can raise price, without risking entry[24] and rely on excessive market segmentation to restrict price competition.[25] The strategy involves finding mechanisms to sort customers into categories with different price sensitivities and then offering higher prices in the less price sensitive category.[26] Prices[27] and profits at hubs are higher.[28] Since they do not face effective competition, they do not feel compelled to improve quality.

Examples of clearly abusive pricing are also too frequent and too blatant to ignore. The state Attorney's General give three types of examples where fares differ by $700 or more: one airport originates flights to destination airports with dramatically different levels of competition; nearby airports with dramatically different levels of competition originate flights to the same destination; prices charged before and after a competitor is driven from the market.[29] The Department of Transportation has recently identified 19 routes on which new entrants were successful in establishing a presence in short haul hub markets in the past three years.[30] The resulting price reductions were in the range of 33 and 55 percent, with increases in passengers of between 61 and 86 percent.

BUILDING BLOCKS OF A HIGHLY CONCENTRATED INDUSTRY

The monopolized hubs are building blocks of potential national market power through concentration of the industry. The geographic extension that United and American are seeking (soon to be followed by some combination of Delta, Northwest and Continental) and the denser network that the mergers would create make it less and less likely that competitors will be able to attack these markets.

As all such airline networks do, these mergers would lock travelers in by concentrating their flow through fortress hubs, coordinating scheduling at those hubs, and binding them with frequent flier and other promotional programs. These mergers are likely to promote a movement from fortress hubs to fortress regions.

Industry structure has become sufficiently concentrated to raise a fundamental question about whether market forces are sufficient to prevent the abuse of market power. Both at individual hubs and in the industry as a whole, markets have become or are becoming highly concentrated. Attorney's General from 25 states filed comments in support of the Department of Transportation's anti-predation rule which identified 15 airports at which the dominant firm had a market share in excess of 70 percent. This is the standard generally applied to indicate monopoly status. Another half dozen airports have a dominant carrier (50 to 70 percent market share) close to the monopoly (see Exhibit 3).

This is not a small airport problem. Seven of the ten busiest airports in the country are on the list. One-half of all passenger enplanements take place at the twenty airports on the list. These fortress hubs are the cornerstone of a nationwide problem. The local monopolies are reinforced by an industry structure in which there is simply inadequate competition to discipline the abuse of market power. There are too few competitors in the industry as a whole and in most markets on a route-by-route basis.

Let us step back a moment on consider what constitutes "too few" competitors. Identification of exactly where a small number of firms can exercise market power is not a precise science, but it is widely recognized that when the number of significant firms falls into the single digits public policy concerns are triggered.[31] In fact, I like to use what I call the "Ed Meese tests of market power." You will recall that based on the extensive theoretical and empirical record of decades of analysis, Ronald Reagan's Department of Justice headed by Ed Meese issued the *Merger Guidelines* in 1984.

The Reagan Administration DOJ established a fundamental threshold to separate an unconcentrated market from a moderately concentrated market at the level of a Hirschman-Herfindahl Index (HHI) of 1000. This level of concentration would be achieved in a market of 10 equal size competitors. In this market, the 4-Firm concentration ratio would be 40 percent. The DOJ established a second threshold at an HHI of 1800. Above this level, the market is considered highly concentrated. This is roughly equal to a market with fewer than six equal sized competitors. A market with six, equal-sized firms would have a HHI of 1667. In a market with six, equal-sized firms, the 4-Firm concentration would be 67 percent.

The reason the six and ten firm thresholds are important is that they constitute well-documented and understood levels of oligopoly. In a tight oligopoly with a small a number of firms controlling such a large market share, it is much easier to avoid competing with each other and harm the public through price increases or quality deterioration.

Shepherd describes this threshold as follows:[32]

> Tight Oligopoly: The leading four firms combined have 60–100 percent of the market; collusion among them is relatively easy.
>
> Loose Oligopoly: The leading four firms, combined, have 40 percent or less of the market; collusion among them to fix prices is virtually impossible.

By these definitions, airline markets are generally highly concentrated. Most routes have fewer than four carriers. National averages typically find HHIs in the range of 4000 on a city-pair basis.[33] One recent study found that, measured at airports, the HHI was just under 3300—the equivalent of three airlines per airport), but measured by city pairs the HHI was over 5000—the equivalent of two per route.[34] Given such a high level of concentration, we should not be surprised to find that anti-competitive behavior and changes in market structure have a significant impact on fares. Exercising market power is easy in such highly concentrated markets.

While market power is best analyzed on a market-by-market basis, since it is the monopoly at the point-of-sale that triggers the abuse, national markets are not irrelevant. As the industry becomes more and more concentrated, the pool of potential major entrants shrinks. The ability of the large dominant firms to avoid one another in the market and engage in conscious parallelism or strategic gaming increases. It is this level of analysis that is frequently lacking in the merger review process, which becomes trapped in the merger-by-merger scrutiny and loses sight of the forest for the trees.

Before the pending merger wave, the industry had become moderately concentrated, with an HHI of approximately 1400. The two pending mergers (United/US Airways and American/TWA) would push it above 1800. A Delta/Northwest or Delta/Continental merger, which is anticipated as a defensive response, would drive it well above 2200. Each of the pending consolidations would violate the *Merger Guidelines* on a national scale, as well as in individual markets. Taken together, they drive the industry structure well above the highly concentrated level

THE PROPOSED REMEDIES ARE KEY ELEMENTS OF A SOLUTION

With two decades of econometric evidence about competitive problems at the levels of structure, conduct and performance reinforced by detailed analysis of recent events, one can only hope that the public policy debate will not revert to the irrelevant question of whether deregulation served the consumer interest. The trigger for public policy concern is, as it always should have been, whether anticompetitive practices are hurting consumers. By every measure, the airlines are failing that test today.

The *Aviation Competition Restoration Act* attacks the problem at its core.

- The Act would provide a more focused set of criteria to assess the impact of mergers and would encourage the Department of Transportation to consider the impacts of mergers in a broader context.
- It also seeks to crack open hubs when one airline gains a majority position. It identifies several of the most important ways in which dominant incumbents have prevented entry into their fortress hubs and would require them to be made available to bona fide entrants.
- It identifies the withholding of facilities as an anticompetitive practice.
- It sets aside funding to expand facilities at dominated hubs and reorients passenger facilities charges in a procompetitive direction.

The logic of these measures is impeccable. Concentration of traffic through hub and spoke networks is clearly an efficient form of organization for the industry. Concentration of ownership and control of slots, gates, facilities and enplanements are clearly the source of abusive market power in the industry. It was never necessary to equate concentration of traffic with concentration of ownership. By opening up half the capacity at fortress hubs, competitors will have a chance to compete for the flow of travelers through these high density airports. The leading firms will continue to have an interest in serving this flows since a 50 percent share of the nation's 35 largest airports is still a very substantial business that captures the efficiencies (economies of scale) in the industry.

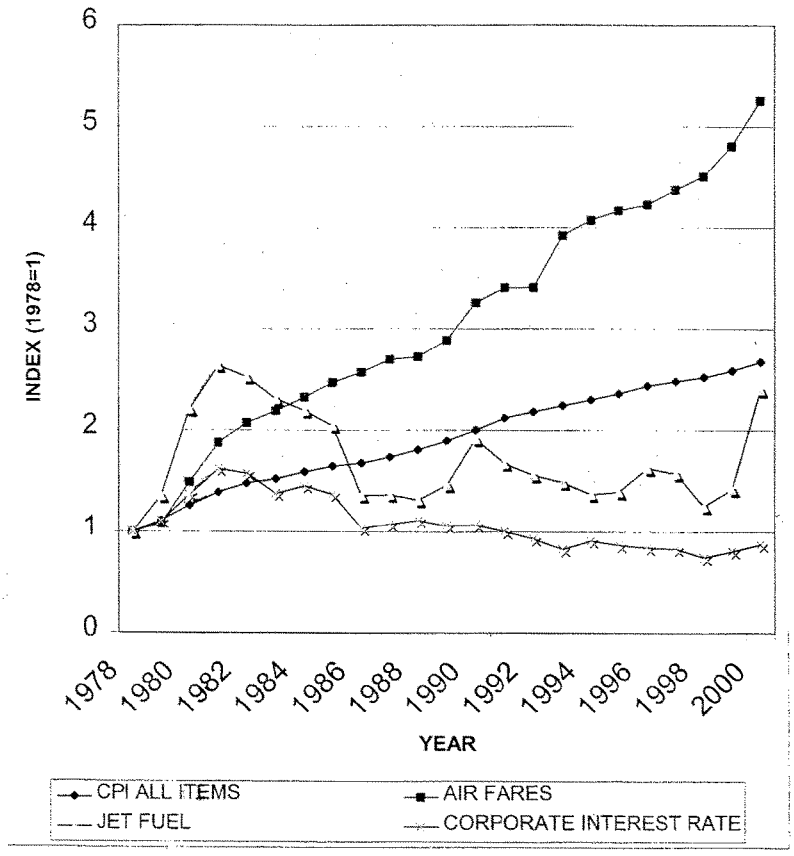
This solution is akin to the open standard/platform solution that we observe in other network industry. We have learned in the computer and electronics industries that open standards are as good as, if not better than, closed standards in achieving efficiency gains (network effects), and infinitely better at preventing anticompetitive abuses. The competitive access provisions are a form of interconnection requirement to ensure fair access to choke points in the network. CFA and CU have vigorously supported these types of competitive access principles in a range of industries[35] and we applaud Senators Hollings and McCain for introducing them into the debate over the airline industry. CFA and CU believe that enactment of the Aviation Competition Restoration Act is an essential first step in preventing further consolidation in the airline industry that would undermine the already inadequate competition that exists in the industry. It opens the way to introducing competition in the fortress hubs that dominate the industry.

EXHIBIT 1:

THE IMPACT OF ANTI-COMPETITIVE MARKET STRUCTURE ON FARES

STUDY	PRACTICE		PERCENT INCREASE IN PRICE
GENERAL MEASURES OF COMPETITION			
Dressner and Trethaway	Competition		35
GAO (1993)	Hub Concentration		33
GAO (1996)	Hub Concentration		31
DOT (1996)	Hub Concentration,	1989	19
		1994	19.7
		1995	22.1
CHANGE IN NUMBER OF COMPETITORS			
Strassman	Add one (2.7 to 3.7)		44
Hurdle (et al.)	Loss of one		20
Windle and Dressner	Add one (2-3)		17
Oum, Zhang and Zhang	Add one (1-2)		17
Borenstein (1989)	Add one (1-2)		8
DOT (2001)	Low cost competitor in Hub		41
		Short Haul Hub	54
ENTRY AND EXIT			
Dressner and Windle	Low cost (Southwest)		35
Whinston and Collins	Low cost (Peoples)		34
DOT (1996)	Low Cost (all Hubs)		35
	Low Cost (Concentrated Hub)		40
DOT (2001)	Low Cost (Hubs)		42
Joskow et al.	Any		10
GENERAL INDUSTRY PRACTICES			
Morrison and Winston (1995)	Hubbing		5.4
	Frequent Flier		7.9
	CRS Manipulation		9.4
	(Subtotal)		22.7
	Fare restrictions		23.8
	Total		46.5
Stavins (1996)	Fare restrictions		20-40

EXHIBIT 2:
CHANGES IN AIR FARES AND RELATED ITEMS



SOURCE: Bureau of Labor Statistics, *Consumer Price Index, Consumer Price Index,* CPI, Air Fares, Jet Fuel; *Economic Report of the President,* January 2001, Corporate AAA Bond Rates; Department of Commerce, *Statistical Abstract of the United States*, Airline Cost Indices, various issues.

EXHIBIT 3

DOMINANT AIRLINES PROPOSING GREATER CONCENTRATION
WITH FORTRESS HUBS THAT EXCEED MONOPOLY STANDARD

AIRPORT	AIRLINE	DOMINANT FIRM MARKET SHARE
MONOPLY (70+ PERCENT)		
ATLANTA	DELTA	80%
CHARLOTTE	US AIRWAYS/UNITED	91
CINCINNATI	DELTA	90
DALLAS/FT. W	AMERICAN	71
DENVER	UNITED/US AIRWAYS	73
DETROIT	NORTHWEST	78
HOUSTON INTL	CONTINENTAL	83
MEMPHIS	NORTHWEST	75
MINNEAPOLIS	NORTHWEST	80
PHILADELPHIA	US AIRWAYS/UNITED	73
PITTSBURGH	US AIRWAYS/UNITED	89
SALT LAKE	DELTA	72
ST. LOUIS	TWA/AMERICAN	76
WASH. DULLES	UNITED/US AIRWAYS	74
DOMINANT FIRMS (50-70 PERCENT)		
CHICAGO	UNITED/US AIR	50
CLEVELAND	CONTINENTAL	50
MIAMI	AMERICAN/TWA	56
NEWARK	CONTINENTAL	61
OAKLAND	SOUTHWEST	68
SAN FRANCISCO	UNITED/US AIRWAYS	53

ENDNOTES

1. The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over two hundred and forty state and local affiliates representing consumer, senior-citizen, low-income, labor, farm, public power and cooperative organizations, with more than fifty million individual members.

2. Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the State of New York to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports,* with approximately 4.5 million paid subscribers, regularly carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

3. American Bar Association, *The Air and Space Lawyer,* January 1999.

4. A broad range of studies includes the Herfindahl index as a measure of concentration. These invariably find that higher levels of concentration are associated with higher prices, all other thing equal—see, for example, Morrison and Winston (1986), Borenstein (1989), Dresner and Trethaway (1992), Dresner and Windle (1996).

5. Graham, Kaplan and Sibley (1983), Call and Keeler (1985), Morrison and Winston (1986), Moore (1986), Strassman (1990), Petraf (1994), Petraf and Reed (1994), provide evidence on actual competition. Tests of potential competition have generally shown much smaller effects. The evidence suggests that one competitor in the hand is worth between three and six in the bush. The empirical evidence from the airline industry must be considered a thorough repudiation of contestability theory. On this point see Borenstein (1989), Butler and Houston (1989), Hurdle (1989), Abbott and Thompson (1991).

6. The clearest examples of the importance of barriers to entry are the consistent finding that physical limitations on slots and gates result in less competition and higher prices. Virtually every econometric analysis includes a slot variable which supports this conclusion—see, for example, Morrison and Winston (1986, 1990), Hurdle (1989), Whinston and Collins (1992), Windle and Dresner, 1995, and Dresner, Lin and Windle (1996). Analysis of legal barriers reaches similar results—see Dresner and Trethaway (1992), Burton (1996).

7. Borenstein (1990), Werden et al. (1991), and Morrison and Winston (1995).

8. Rakowski and Bejou (1992), Oum Zhang and Zhang (1995).

9. The unique problems of small airports and low density routes were recognized in the legislation ending the existence of the CAB—see Meyer and Oster (1984) and Malloy (1985).

10. Johnson (1985), McShane and Windle (1989), Oum and Trethaway (1990), Berry (1990), Morrison and Winston (1990), Oum (1991), Berry (1992), Boucher and Spiller (1994), Joskow, et al (1994).

11. Levin (1987), Bornstein (1989, 1992), Zhang (1996).

12. Evans and Kessides (1993).

13. Oum and Taylor (1995).

14. Levine (1987), Oum (1987), Borenstein (1989), Layer (1989), GAO (1996).

15. Levine (1987), Borenstein (1989, 1991, 1992), Morrison and Winston (1995).

16. Oster and Pickerell (1986), Borenstein (1989), Layer (1989), Brenner (1989), Evans and Kessides (1993).

17. Oum (1995) identifies three positive advantages created by code sharing—increased frequency of flights, concentration of traffic, marketing of single line travel—and one negative—CRS placement advantages due to frequency and single line service.

18. Berry (1987), Levine (1987), Borenstein (1989), Butler and Houston (1989), Reiss and Spilber (1989), Oum, Zhang and Zhang (1995), and Hendricks (1995).

19. Levine (1987), Borenstein (1989), Kahn (1993), GAO (1996).

20. GAO (1996).

21. Credible entry requires the entrant to move sufficiently up the S-curve to have a viable economic base (Russon (1992), Vakil and Russon (1995). GAO notes that entrant require at least six slots at prime times to establish a credible presence.

22. DOT, 2001, identifies. A study by ESI.KPMG, *The Advent of National Aviation Networks* (October 2000), sought to justify the consolidation into three national networks on the basis of an analysis that is so fundamentally flawed it lacked any identified authors. The analysis ignores all price effects due to the loss of competi-

tors. It uses an econometric estimate of gains from online traffic that assumes the price of a ticket has no effect on air travel. It excludes all large hubs all airports served by Southwest all Essential Air Service airports, all airport served within 50 miles of a hub and all airports in leisure markets to derive a coefficient for network effects that is not statistically significant by traditional standards (i.e. it fails the 95 percent confidence interval). It applies this statistic to all airports to derive its estimate of positive benefits.

23. "Comment of the Attorneys General of the States of Arkansas, Connecticut, Florida, Iowa, Kansas, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nevada, New York, North Carolina, North Dakota, Oklahoma, Oregon, South Dakota, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming," U.S. Department of Transportation, 1998, Docket No. OST 98–3713 (hereafter, Attorneys General.

24. The fact that higher prices persist at hubs is evidence of the ability to sustain prices. Direct tests of the entry decision also support this notion (see, for example, Joskow et al (1994).

25. Borenstein (1989) notes that by segmenting markets incumbents can diminish the impact of competition at hub airports. Evans and Kessides (1993), Oum and Zhang (1993), and Mallaiebiau and Hansen (1995) observe a generally low elasticity of demand across all markets.

26. DOT, 2001, notes that while some price discrimination is to be expected, it appears to be excessive in concentrated airline markets.

27. Bailey and Wilkins (1988), Huston and Butler (1988), Borenstein (1989), Evans and Kessides (1993), Joskow, et al. (1994), GAO (1996), DOT (1996).

28. Toh and Higgins (1985), McShane and Windle (1989).

29. Attorneys General.

30. U.S. Department of Transportation (2001).

31. Friedman, 1983, pp. 8–9,

Where is the line to be drawn between oligopoly and competition? At what number do we draw the line between few and many? In principle, competition applies when the number of competing firms is infinite; at the same time, the textbooks usually say that a market is competitive if the cross effects between firms are negligible. Up to six firms one has oligopoly, and with fifty firms or more of roughly equal size one has competition; however, for sizes in between it may be difficult to say. The answer is not a matter of principle but rather an empirical matter.

32. Shepherd, 1985, p. 4, see also Bates, B. J. 1993, p. 6.

33. See for example, Dresner, Lin and Windle (1996). City-pair markets generally include all flights between to points including direct and connecting (single airline) flights.

34. Hayes and Ross.

35. On telecommunications, see Cooper, 1997, 1998; on the Internet see Cooper, 2000a, b; on electricity, see Cooper, 2000b; on software see Cooper 2001 (forthcoming).

BIBLIOGRAPHY

Allvine, Fred C., "Predatory Pricing and 'Fortress Hubs': Monopolization in the Airline Industry," 1997, *Antitrust Law and Economics*

Baker, S. H. and J. B. Pratt, 1989, "Experience as a Barrier to Contestability," *Review of Economics and Statistics*.

Bates, B. J., 1993, "Concentration in Local Television Markets," *Journal of Media Economics.*

Bennett, R.D. and J. M. Craun, 1993, *The Airline Deregulation Evolution Continues: The Southwest Effect.*

Berechman, J. and O. Shy, 1996, "Airport Deregulation and the Choice of Networks," in P. Nijkamp (ed.), *Advances in Spatial Equilibrium*, Berlin: Springer Verlag.

Berechman, J. and J. de Wit, 1996, "An Analysis of the Effects of European Aviation Deregulation on an Airline's Network Structure and Choice of a Primary European Airport Hub," *Journal of Transport Economics and Policy*.

Berry, S. T, 1992, "Estimation of a Model of Entry in the Airline Industry," *Econometrica*.

———————, 1990, "Airport Presence as Product Differentiation," *AEA Papers and Proceedings*.

Borenstein, S., 1989, "Hubs and High Fares: Dominance and Market Power in the U.S. Airline Industry," *Rand Journal of Economics.*

———————, 1990, "The Dominant Firm Advantage in Multi-Product Industries: Evidence of the U.S. Airlines," *Quarterly Journal of Economics.*

———————, "Airline Mergers, Airport Dominance, and Market Power," *AEA Papers and Proceedings.*

Brander, J.A. and A. Zhang, 1990, "Market Conduct in the Airline Industries: An Empirical Investigation," *Rand Journal of Economics.*

———————, 1993, "Dynamic Oligopoly Behavior in the Airline Industry," *International Journal of Industrial Economics.*

Brenner, M. A., 1989, "Action Needed to Correct Pricing and Service Distortions of Airline Deregulation," *American Economic Review.*

Breyer, S., 1990, "Regulation and Deregulation in the United States: Airlines, Telecommunications and Antitrust," in G. Majone (ed), *Deregulation or Re-Regulation: Regulatory Reform in Europe and the United States*, St. Martins.

Brooks, M. and K. J. Button, "Yield Management: A Phenomenon of the 1980s and 1990s?" *International Journal of Transport Economics.*

Brueckner, J. K. and P. T. Spiller, 1991, "Competition and Mergers in Airline Networks," *International Journal of Industrial Organization.*

Brueckner, J.K, N.J. Dyer and P.T. Spiller, 1992, "Fare Determination in Airline Hub-and-Spoke Networks," *Rand Journal of Economics.*

Butler, R.V. and J. H. Huston, 1989, "How Contestable are Airline Markets?", *Atlantic Economic Journal.*

Button, K. 1996, "Liberalizing European Aviation," *Journal of Transportation Economics and Policy.*

Call, G. D. and T. E. Keeler, 1985, "Airline Deregulation, Fares, and Market Behavior: Some Empirical Evidence, in f. Daugherty, ed., *Analytic Studies in Transport Economics* (Cambridge University Press).

Consumers' Association, 1996, *Consumers' Association Comments on the Proposed Alliance Between British Airways and American Airlines.*

Cooper, Mark, 1987, *The Downsides of Deregulation: A Consumer Perspective after a Decade of Regulatory Reform*, Consumer Assembly.

———————, 1989, "Testimony of Dr. Mark Cooper, Director of Research on Airline Competition," *Subcommittee on Aviation, Commerce, Science and Transportation Committee, United States Senate.*

———————, 1991, "Testimony of Dr. Mark Cooper, Director of Research on Airline Competition and Consumer Protection," *Subcommittee on Aviation, Committee on Public Works Transportation U.S. House of Representatives.*

———————, 1997a, *Open Skies: Closed Airports: The Impact of the British Airways-American Airlines Merger on Trans-Atlantic Travel.*

———————, 1997b, *Last Chance for Local Competition: Policies to Open Markets Before Baby Bells Begin to Sell In-Region Long Distance Service.*

———————, 1998, Affidavit of Mark N. Cooper on Behalf of the Consumer Federation of America, before the Public Utility Commission of California R.93–04003, I.93–04–002, R.95–04043, R.85–04044.

———————, 2000,a "Testimony Of Dr. Mark N. Cooper, On The Proposed United Airlines-Us Airways Merger," *Antitrust Committee, United States Senate*, June 14, 2000

———————, 2000b, "Open Access to the Broadband Internet: Technical and Economic Discrimination in Closed Proprietary Networks," *University of Colorado Law Review.*

———————, 2000c, "The Role Of Technology And Public Policy In Preserving An Open Broadband Internet

The Policy Implications Of End-To-End, Stanford Law School.

———————, 2001, "Antitrust as Consumer Protection in the New Economy: Lessons from the Microsoft Case," *Hastings Law Journal*, forthcoming.

Dresner, M. and M. W. Threthaway, 1992, *Modeling and Testing the Effect of Market Structure on Price: The Case of International Air Transport*, University of Maryland.

Dresner, M. and R. Windle, *The Liberalization of US International Air Policy: Impact on US Markets and Carriers*, University of Maryland.

Dresner, M., J. C. Lin and R. Windle, 1996, "The Impact of Low-Cost Carriers on Airport and Route Competition," *Journal of Transport Economics and Policy.*

ESI, GKMG Consulting, *The Advent of Aviation Networks*, October 2000.

Evans, W. N. and I. A. Kessides, 1993, "Localized Market Power in the Airline Industry," *Review of Economics and Statistics.*

Friedman, J.W., 1983, *Oligopoly Theory*, Cambridge University Press.

Good, D. H., L. Roller and R. C. Sickles, 1993, "US Airlines Deregulation: Implications For European Transport," *The Economic Journal.*

Graham, D. R., D. P. Kaplan and D. S. Sibley, 1983, "Efficiency and Competition in the Airline Industry," *Bell Journal of Economics.*

Hayes, Kathy J. and Leola B. Ross, "Is Airline Price Dispersion the Result of Careful Planning or Competitive Forces?," 1998, *Review of Industrial Organization.*

Hendricks, K., M. Piccione and G. Tan, 1995, "The Economics of Hubs: The Case of Monopoly," *Review of Economic Studies.*

Hurdle, et al., 1989, "Concentration, Potential Entry, and Performance in the Airline Industry," *Journal of Industrial Organization.*

Jordan, W. A., 1989, "Problems Stemming from Airline Mergers and Acquisitions," *Transportation Journal.*

Jorge-Calderon, J.D., 1996, "Evaluating the Effectiveness of Airline Operation Strategies in UK International Markets," *International Journal of Transport Economics*.

Joskow, A. S., et al., 1994, "Entry, Exist and Performance in Airline Markets," *International Journal of Industrial Organization.*

Kahn, A.E., 1992, "Airline Deregulation: A Mixed Bag but a Clear Success," *Transportation Journal*.

Kahn, A. E., 1993, "The Competitive Consequences of Hub Dominance: A Case Study," *Review of Industrial Organization.*

Kling, J. A. and K. A. Smith, 1995, "Identifying Strategic Groups in the U.S. Airline Industry: An Application of the Porter Model," *Transportation Journal.*

Layer, C.R., 1989, "The Next Decade Belongs to the Airlines Unless...," *Transportation Quarterly.*

Levine, M.E., 1987, "Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy," *Yale Journal on Regulation*.

Malloy, J. F., 1985, *The U.S. Commuter Airline Industry*, Lexington Books.

Meyer, J. R. And C. V. Oster, 1984, *Deregulation and the New Airline Entrepreneurs*, MIT Press.

McShane, S. and C. Windle, 1989, "The Implications of Hub and Spoke Routing for Airline Costs and Competitiveness," *Logistics and Transportation Review.*

Mallaiebiau E., and Mark Hansen, 1994, "Demand and Consumer Welfare Impacts of International Airline Liberalization," *Journal of Transport Economics and Policy.*

McCartney, S., 1996, "Air Pressure: Start-Ups Still Suffer from ValuJet Crash and FAA's Missteps," *Wall Street Journal,* December 9.

Moore, T. G., 1986, "U.S. Airline Deregulation: Its Effects on Passengers, Capital, and Labor, *Journal of Law and Economics*.

Morrison, S. A. and C. Winston, 1986, *The Economic Effects of Airline Deregulation,* Brookings, Washington, D. C.

———————, 1987, " Empirical Implications and Tests of the Contestability Hypothesis," *Journal of Law and Economics.*

———————, 1989, "Enhancing the Performance of the Deregulated Air Transportation System," *Brookings Papers on Microeconomics.*

———————, 1990, "Deregulated Airline Markets: The Dynamics of Airline Pricing and Competition," *AEA Papers and Proceedings.*

———————1995, *The Evolution of the Airline Industry*, Brookings, Washington, D.C.

Morrison, S. A., 1996, "Airline Mergers: A Longer View," *Journal of Transport Economics and Policy.*

Nero, Giovanni, 1999, "A Note on the Competitive Advantage of Large Hub-and-Spoke Networks," Transportation Research, Part E.

Oster, Clinton V. and John S. Strong, 2001, *Predatory Practices in the U.S. Airline Industry*, January 15.

Ott, J. and R. E. Neidl, 1995, *Airline Odyssey,* McGraw Hill.

Oum, T. H., D. W. Gillen, and S. E. Nebble, 1986, "Demand for Fareclass and Pricing in Airline Markets," *Logistics and Transportation Review*.

Oum, T. H., W. G. Waters and J. Yong, 1992, "Concepts of Price Elasticity of Transport Demand and Recent Empirical Estimates," *Journal of Transport Economics*.

Oum, T. H., A. Zhang and Y. Zhang, 1993, "Inter-Firm Rivalry and Firm-Specific Price Elasticities in Deregulated Airline Markets," *Journal of Transport Economics and Policy.*

———————, 1995, "Airline Network Rivalry," *Canadian Journal of Economics.*

Oum, T. H. and A. J. Taylor, 1995, "Emerging Patterns in Intercontinental Air Linkages and Implications for International Route Allocation Policy," *Transportation Journal.*

Oum, T. H., J. Park and A. Zhang, 1996, "The Effects of Airline Codesharing Agreements on Firm Conduct and International Airfares," *Journal of Transport Economics and Policy.*

Petraf, M. A. and R. Reed, 1994, "Pricing and Performance in Monopoly Airline Markets," *Journal of Law and Economics.*

Petraf, M. A., 1995, "Sunk Costs, Contestability and Airline Monopoly Power," *Review of Industrial Organization*.

Rakowski, J.P. and David Bejou, 1992, "Birth, Marriage, Life and Death: A Life-Cycle Approach for Examining the Deregulated U.S. Airline Industry," *Transportation Journal*.

Reiss, P. and P. Spiller, 1989, "Competition and Entry in Small Airline markets," *Journal of Law and Economics.*

Shepherd, W.G. 1985, *The Economics of Industrial Organization*, Prentice Hall.

Strassman, D.L., 1990, "Potential Competition in the Deregulated Airlines," *Review of Economics and Statistics.*

The National Commission to Ensure A Strong Competitive Airline Industry, 1993, *A Report to the President: Change, Challenge, and Competition*, Washington, D.C.

Town, R. and S. Milliman, 1989, "Competition in Deregulated Airline Fares," in L. W. Weiss (ed.), *Concentration and Price,* Cambridge, MIT Press.

Transport Committee, House of Commons, 1996, *The Proposed Alliance Between British Airways and American Airlines,* Sixth Report: Report and Minutes of Proceedings, Session 1995–1996.

Transportation Research Board, 1991, National Research Council, *Winds of Change,* Special Report 230.

———————, 1999, *Entry and Competition in the U.S. Airline Industry: Issues and Opportunities:* Special Report, 255.

Transworld Airlines, Inc., 1996, *Market Effects of the Proposed American Airlines/British Airways Alliance, GRA, Incorporated.*

U.S. Department of Justice, *Merger Guideline*, revised, 1984.

U.S. Department of Transportation, 1993, *The Airline Deregulation Evolution Continues: The Southwest Effect,* Washington, D. C.

———————, 1996, *The Low Cost Airline Service Revolution,* Washington, D.C.

———————, 1998, Docket No. OST 98–3713.

———————, 2001, *Dominated Hub Fares,* January,

———————, 2001, *Enforcement Policy Regarding Unfair Exclusionary Conduct in the Air Transportation Industry*, Docket OST–98–3713, January 17.

U.S. General Accounting Office, 1990, *Airline Competition: Industry Operating and marketing Practices Limit Market Entry,* Washington, D.C.

———————, 1991, *Airline Competition: Effects of Airline Market Concentration and Barriers to Entry On Airfares*, Washington, D.C.

———————, 1996, *Airline Deregulation: Barriers to Entry Continue to Limit Competition in Several Key Domestic Markets,* Washington, D.C.

Vakil, F. And M. G. Russon, 1996, "Enplaned Passenger Flight Frequency Functions for Short Hauls Air Transport Passenger Flows," *Logistics and Transportation Review.*

Virgin Atlantic Airways Limited, 1996, *Presentation to the House of Commons Transport Select Committee in Opposition to the Proposed Alliance Between British Airways and American Airlines.*

Werden, G.J., A.S. Joskow and R. L. Johnson, 1989, "The Effects of Mergers on Economic Performance: Two Case Studies from the Airline Industry," *U. S. Department of Justice Discussion Paper*, No. EAG 89–15.

Whinston, M. D. and S. C. Collins, 1992, "Entry and Competitive Structure in Deregulated Airline Markets: An Events Study Analysis of People Express," *Rand Journal of Economics.*

Windle, R. and M. Dresner, 1995, "Airport Choice in Multiple Airport Regions," *Journal of Transportation Engineering.*

———————, 1995b, "The Short and Long Run Effects of Entry on US Domestic Air Routes," *Transportation Journal.*

Williams, G., 1995, *The Airline Industry and the Impact of Deregulation*, Aldershot:

Avebury Aviation.

Zhang, A., 1996, "An Analysis of Fortress Hubs in Airline Markets," *Journal of Transport Economics*

The CHAIRMAN. Attorney General Miller, I want to thank the National Association of Attorneys Generals for their active participation in this issue, and we appreciate it very much.

You State that you believe that a shift of the slots owned by TWA at National to low-cost competitors is possible and appro-

priate. Some would argue this is a takings, either legally or because of the significant investment in slots by the airlines. How would you respond to that charge?

Mr. MILLER. Well, there's a number of ways to deal with that. One is to provide them some fair competition, some fair return, but do it in a way that does not continue the concentration that Mark spoke of—some way that they do go to competitors but there is some competition.

But also, keep in mind that the slots were created by the government. They are a government-created ability to land and to take off. They were not property that was created by any way in the private sector, so you have that consideration, as well.

The CHAIRMAN. Thank you.

Mr. Kahan.

Mr. KAHAN. If I could embellish that a little bit, I think the takings arguments just flies in the face of the regulation itself which says that the slots are not property, that they remain with the government.

In terms of the equity of it, I don't understand that argument either. People who have had these slots have been able to use them for many years. They got them for free, all right, for the most part. It's actually distorted competition because people who got their slots for free and who now think that they have property which they should pledge as security collateral to a bank and get a couple of million dollars and do things like that, actually make it that much harder for us who don't have that kind of assistance for our balance sheet. It's a distortion, not a——

So, to me, I think that we ought to act in the public interest, let those who believe it's a taking go to court, and I predict that the public interest will win that one.

The CHAIRMAN. Ms. Hecker, I have seen your charts of the differences in fares where there's competition and where there isn't, something that, one, we all know about and, two, makes sense. Do you believe that—however, that the major airlines have engaged in predatory practices in order to drive these new entrants out of their markets and eventually out of business?

Ms. HECKER. I think there has been substantial research that has raised questions. I obviously haven't done a specific investigation of specific firms.

I think one connection, when we pulled the data for this hearing today, was very interesting. There were three pieces of data on market concentration, data on fare differentials, and the research that we'd done in terms of restricted access to gates. And there were four airports that came up to the top of the list of every one of those—the highest levels of concentration, the highest incremental fares, and also the most consistent evidence of the restriction of access to gates—and that's Charlotte, Pittsburgh—what are the four of them—Minneapolis, and Cincinnati.

That kind of consistency—in terms of domination, fare differentials, and clear evidence of restricted access to gates—raises substantial questions about how market power is used and how it's being clearly used to do both the two things that a monopoly provides you—A, to get monopoly rent, and, B, to further restrict access to secure your monopoly position.

Mr. MILLER. Senator, if I could expand on that just briefly, it's important to keep in mind pricing and capacity, that typically what the major will do is meet the price of the new entrant. But then if they, in addition, expand considerably their capacity between the city pairs, those two together can be the predatory knockout, and that's what the American Airlines case is about that DOJ brought that could set some important precedents.

The CHAIRMAN. Mr. Neeleman, some argue that some of the first routes to go in the event that an airline is forced to give up gates in a dominant hub are those to small- and mid-sized communities. Do you agree with that assessment?

Mr. NEELEMAN. I don't. And being from Salt Lake City, the example that Mr. Burns gave, I know that—I'm very familiar with Sky West Airlines and very familiar with Delta Airlines and their operation in those areas. You know, they serve those communities largely because they're profitable for them; and I guess charging the kinds of fares they're charging, it would not be difficult for it to be profitable for them. But, you know, I think the issue is more the underutilization and the squatting on gates and squatting on ticket counters and the——

The CHAIRMAN. I think there was a case in Chicago where three gates were used to storage of additional equipment for a long time. Are you familiar with that story?

Mr. NEELEMAN. I've heard of that, and I've heard others, too, at Dallas Love Field and other places, but, you know, our analysis—and we've looked around—there's some consolidation going on at Kennedy that we're a little bit concerned about, and there's three terminals in question. We went and looked at the gate allocation at the two and then at the third and saw that it would—could quite easily be consolidated into two, even though there's positions that say they couldn't. So, yeah, I think it happens everywhere, and I think——

The CHAIRMAN. Well, can you discuss some of the markets you've had difficulty entering?

Mr. NEELEMAN. Well, I think the example I gave—you know, People Express had a tremendous amount of success flying to Norfolk, Virginia, to cities in the Carolinas—North and South Carolina. It's very difficult for us to be able to fly New York to the Carolinas and rely solely on that point-to-point business without feeding traffic from the north. We can't have access to Boston. We've gone there a couple of different times, and all they want to do is point us to other airports. There are no gates available. With this consolidation and these mergers——

The CHAIRMAN. Have you tried Chicago?

Mr. NEELEMAN. Yes. We can't—we visited Chicago and can't have access to Chicago. And obviously, Boston and Chicago are two of the largest——

Senator BURNS. That's either Midway or O'Hare?

Mr. NEELEMAN. Obviously, there's a slot issue at O'Hare. We've been to Midway, and currently there are no gates at Midway.

The CHAIRMAN. My time has expired.

Senator Hollings.

Senator HOLLINGS. Thank you, Mr. Chairman. Let me apologize to the panel because we had to get down on the floor, and I really appreciate your appearance.

Mr. Neeleman, can we get JetBlue to South Carolina?

Mr. NEELEMAN. You know, you had a carrier to Columbia, South Carolina, that provided service to New York called Air South and they had their problems, and they had their issues, but I was impressed, as I looked from afar, at the number of passengers that flew from Columbia to JFK, actually where we serve.

It would be difficult for us just to serve those two markets without having service to the north. We would be more apt to serve South Carolina if we had service to Boston. That way we could serve Boston, New York, and the Carolinas, particularly in South Carolina, where some of the population bases are a little bit smaller.

So it's on our list of cities. We're looking at it, but we need access, to be able to do it, to some of the larger markets to flow passengers through.

Senator HOLLINGS. But what we really need is to just get flights into Charlotte. You see, we have——

[Laughter.]

Senator HOLLINGS [continuing]. People from Columbia and people from Greenville who get in their car and drive to Charlotte, because the fare from Charlotte to Washington is minimal. It's the outrageous cost of trying to get to Charlotte.

Mr. NEELEMAN. Right.

Senator HOLLINGS. And if we can get these little feeder ins, not to go all the way to Washington and all the way to New York—now, back to the answer Mr. Kahan was giving relative to slots, these slots were all developed by the communities. They belong to the communities themselves and not to the airlines. But I learned the hard way. We had three flights up and three back by National Airlines from my hometown of Charleston, South Carolina. And when Air Florida crashed out here, then the slots were sold by Air Florida. They went out of business and just took the money and ran. And all of a sudden the community that had developed the—no airline that I know of has built runways or built towers or added slots or added facilities or anything else. The airlines never have paid for those things. The communities have to do it, Mr. Kahan, and don't you agree that the slots belong, really, to the communities that develop them?

Mr. KAHAN. Yeah, I thought we had resolved that for all time when we had our hearing in Charleston last year, sir——

[Laughter.]

Mr. KAHAN [continuing]. And I totally agree with that. I answered a question from the Chairman along those lines.

On a positive note, though, I would like to thank you for our service from Myrtle Beach to Chicago, which is going to start on Thursday. And I know you don't want to drive up Route 17, but I think that the fare differential between Charlotte and Myrtle Beach is going to encourage a lot of your constituents to do that.

Senator HOLLINGS. Let me ask, in the limited, because the colleagues who have been waiting here—and I'm out of our order, but with the courtesy of the Chairman here—what's wrong with this

bill? How can we clean it up or get rid of it because it's a bad bill, or what improvements? Who wants to criticize the bill or the initiative? All we're trying to do is inject competition back into airline travel. How would you improve this measure or——

Mr. MILLER. Well, first of all, I think——

Senator HOLLINGS [continuing]. If it is wrong?

Mr. MILLER [continuing]. I think the major thrust of the bill is right on the money, to deal with some of the problems of expanding competition throughout the country. And, in particular, I think it's strong in addressing the gates issue which has been somewhat neglected. I think the merger thrust is very good, as well.

You know, I've heard the comments earlier about the huge merger—United and US Airways. The attorney generals of this country are investigating that. We're committing considerable resources to look at that. We're concerned, on that front, that if we let that happen and develop this oligopoly, we'll all regret the day.

So, you know, I think the major principles that you're embarking upon are exactly right. We would be glad to work on some of the details, particularly on the gates, and try and fine tune that. Tom Ormiston from my staff is here today and would certainly work with your staff. But I think the major thrust of what you're doing is right on course.

Senator HOLLINGS. Thank you very much. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you.

Senator Burns.

Senator BURNS. I'll have to ask Mr. Miller what was wrong when, back in the days of—(inaudible)—Airlines, when we stopped at Kansas City, St. Jo—(inaudible)—Cedar Rapids, Tri Cities, Rockford, and Chicago and we still sold some Chicago tickets.

[Laughter.]

Mr. MILLER. Those were, in some ways, the good old days.

[Laughter.]

Mr. MILLER. On the other hand, deregulation has decreased prices, consumers fly at much greater level throughout the country today. So deregulation was a very positive step. It's just an attempt to try and make sure the benefits are extended to places like Montana and Iowa and other places.

Senator BURNS. I will have to agree with that, because basically we have as good a jet service in Montana. I can't complain at all. I can complain a little bit about—on the fares and that type thing, but we can't complain about the service.

But, Ms. Hecker, I was interested in your—and you said you had—we have some secondary problems with this business of predatory pricing and this type thing. Would that be in the reservation system?

Ms. HECKER. That's one of the practices that really should be further investigated and should be examined. I think there are some issues about potential bias in reservation systems, but it really extends beyond just the system itself.

There continue to be issues about commission overrides and special agreements that airlines have with travel agents to induce less-than-biased advice to passengers.

And then there are other issues about airline negotiations with businesses where they give them special deals, but some of them have conditionality that—we'll give you a good deal on the flights where we fly as long as you don't fly on some of these other low-cost carriers—and are looking at establishing for conditions that really restrict open choices in markets.

So there are a range of practices that are of concern, and that's really why we support the intent of the bill to have a far more rigorous oversight by DOT of these practices.

Senator BURNS. Mr. Hauenstein, I'm interested in your testimony here. Whenever US Airways and you bid on part of their operation with—and then were still going on in—with United Airlines with that merger. Were you given any reason why you were denied access or to even try to price out parts of US Airways?

Mr. HAUENSTEIN. It is our belief that the duopoly had already carved up the assets, and we were precluded from participating in a fair bidding process for the D.C. Air assets.

Senator BURNS. Well, when Eastern—I think when Eastern ceased to operate and they went into bankruptcy, I think they were piecemeal-ed out, weren't they? Am I not correct on that? Mr. Kahan, do you remember that?

Mr. KAHAN. Oh, I remember being at the bankruptcy auction. I can tell you an anecdote from that. I remember being there at 2 o'clock in the morning, and I was representing Air Canada. We wanted three gates. These are the three gates, by the way, where I think the vehicles are parked, F1, 2, and 3.

And it turned out that our problem was that United, which is the dominant carrier of Chicago, was making an offer for gates or slots. So about 1:30 in the morning, we realized we were maybe in better shape, because it turned out American wanted slots. So Air Canada and American teamed up together, and we made a bid and then another bid and yet a still higher bid for a package of gates and slots.

And I remember thinking that we were making some progress, but the guys at the United table, which are now some of the guys at US Airways, were just sitting over there like sphinx. And this is now about 2:30, 3:30 in the morning. All right? And at 4 o'clock in the morning——

Senator BURNS. Who in the world was your auctioneer?

[Laughter.]

Mr. KAHAN. Oh, he was quite—he was quite a—he was—he was an attorney.

[Laughter.]

Senator BURNS. Auctioneers usually are.

[Laughter.]

Mr. KAHAN. OK. So at 4 o'clock in the morning——

Senator BURNS. I know something about those fellows.

Mr. KAHAN. At 4 o'clock in the morning, United finally opened their mouth. We had offered $44 million for a package of gates and slots, which was far more than we should have paid. United came up with a $70-million offer, and they blew us away, and that was that.

Senator BURNS. Tell me about, on these gates—and I agree with the attorney general—and some of these things that have come up

with regard—we have never given much regard to gates and more focused on slots, but I think your anecdotal story a while ago about landing early and then sitting out there on the crossways or the taxiways for another 45 minutes—I could write a book about certain airports that I go through all the time, and that is exactly what happens. It's capacity. They don't have the gate capacity, or whatever.

What do you think of some gates being termed as principal-owned gates and then we would have some shared or common gates?

Mr. KAHAN. We benefit from that right now. At La Guardia, where we out-carry TWA, which has multiple gates, we have no gates. We have a single common-use gate, and then we get the pickings and leavings from everybody else. So that's essential, and I commend the Port Authority of New York and New Jersey which has taken the initiative where they can to take back gates and convert them into common-use gates. Otherwise, we would not have an operation there.

Senator BURNS. Now, should that be the authority of the local airport authority, or—rather than the Federal Government?

Mr. KAHAN. I think that that's something which a self-respecting local authority ought to be thinking about all the time, and they have the authority to do that in most cases. But I also believe that the DOT's general unfair and deceptive practices authority, which is at issue in S. 415, should be clarified to ensure that DOT can deal with anti-competitive practices and gate transactions.

Senator BURNS. The reason I say this, because it is of the interest of the community to provide an acceptable fare for business travel in and out of there so they, alone, could probably control the gate situation and maybe in some—but I doubt they will in the slot situation—but they could in the capacity of the airport, as far as gate assignments is concerned.

Mr. KAHAN. Oh, no. Absolutely. Somebody said that the airline business has become the real estate business, and I think that there's a lot of truth to that.

Could I have 20 seconds to say something about CRS at some point?

Senator BURNS. Yes. Yes.

Mr. KAHAN. OK. You asked the question.

Senator BURNS. Well, I'm not the chairman, here. I'm kind of stepping on the man's toes, but——

Senator HOLLINGS. Oh, that's—we've got the list here of Fitzgerald, Carnahan——

Mr. KAHAN. OK, just give me——

Senator HOLLINGS [continuing]. Edwards and then—(inaudible).

Mr. KAHAN [continuing]. Just give me 20 seconds, then I'm—then I'll leave and I'll never bother you again.

Senator HOLLINGS. Go ahead.

[Laughter.]

Mr. KAHAN. OK, 'cause you asked about—you asked a question which I heard as, "What is the relationship between the CRS regulations and predatory practices," and I want to just put on the table one very specific item.

Under the CRS practices, as they have developed since we regulated CRS in 1984, major carriers have realtime access to everything we do because they get the—day after day, they get the CRS tapes. I don't know of any industry—there can't be many of them in our free enterprise system—where that happens. Frankly, I think it's unethical and un-American and it's one of the things that DOT was supposed to do something about.

It definitely facilitates predation. The predator is delighted to know exactly which parts of the marketplace, which travel agencies, which whatever, we're penetrating, where our successes are; and this data permits them to do that, and it's a creature of regulation. So I think that whether you're——

Senator BURNS. I've never supported the centralized reservation system. I've never supported that, and I think that we right back to where the airlines should go ahead and maintain the reservation system, make them inter-operative, but don't make it centralized where you've got—everybody knows about everybody else's business before they do. Thank you, Mr. Chairman. I appreciate that.

Senator HOLLINGS. Yeah.

Senator Fitzgerald.

STATEMENT OF HON. PETER G. FITZGERALD, U.S. SENATOR FROM ILLINOIS

Senator FITZGERALD. Thank you, Mr. Chairman. I was wondering maybe if Mr. Neeleman wanted to address this issue. I noticed that the bill attempts to allow competition in part by giving the Department of Transportation the authority to take airport improvement funds and PFC monies to withhold them and enforce their use in a way which promotes competition at a given airport.

I'm wondering if the bill wouldn't be improved if we gave the DOT the ability withhold those funds and used them instead for the construction of a competitive airport itself. And the reason I bring this up is that in Chicago, one way two major dominant carriers prevent competition is they have been doing anything, and stopping at nothing, to prevent the construction of a third Chicago airport, even though O'Hare has been at capacity since 1969.

Now, they would benefit if another runway was built at O'Hare, because United and American would just carve up that additional capacity and make sure nobody else was able to get any part of the 87 percent of the Chicago market that they enjoy.

A company like JetBlue might have an opportunity of flying into the Chicago market if there were a new airport in Chicago, and I wondered if you had any comment on that.

Mr. NEELEMAN. Well, obviously, one of the big issues facing the overcapacity today—we talk a lot about airspace, but I think a lot of it has to do with blacktop. If you've ever been in the cockpit of an airplane and lined up for landing right after another, it's a little hair-raising sometimes to be going through that knowing that we're really at capacity for blacktop.

So there needs to be blacktop, there needs to be more runways. And I understand your concern about O'Hare. If there was just another runway there, but there also needs to be runways in places where there are people and people willing to travel. I think to the extent—airports are very expensive propositions, billions and bil-

lions of dollars, and so there needs to be a lot of thought to make sure that if something is built, that it will be commercially attractive, that there are people around.

I know in the Chicago area, you know, just over the border, I know that the airports have been promoting an airport in Gary, Indiana. And so, obviously, those are issues there. And it's pretty fascinating to watch, but we are from the outside looking in. We aren't allowed to, at this time, serve anything there because there isn't the airport to the south. It doesn't exist yet. And so we're relegated to either going to Indiana or just waiting for some gates or slots to become available.

Senator FITZGERALD. Well, I'm wondering if Ms. Hecker would want to discuss this issue, too. If you just add capacity at an existing airport where you have a dominant carrier, even if there were some provisions to try and assure that that added capacity went to new entrants to provide some competition, aren't those new entrants, in many ways, dependent on the dominant carrier at that airport, whether it's for contracts to provide fuel, services, or any other kind of subcontracts that they might take?

And is it unreasonable to consider giving the DOT the ability to withhold some of this money and require that it be used for the construction of an entirely competitive facility?

Ms. HECKER. In the statement, we're very supportive of the conditionality for the funds. This is something we've been talking about for about 5 years now and looked at that.

The airports clearly have the leadership authority, in terms of overseeing and ensuring competitive access, but the conditionality of those funds is critical. I think it would take some more examination of somehow requiring any funds withheld to be used for some other purpose, though, because, as we just heard, the complexity of financing a new airport, getting the underwriting, getting the bond markets to support it, getting the airlines that make the financial commitment to underwrite it is a very complex process.

Actually, in that light, there was the earlier question about what kind of improvements could be made in the bill. I mean, the historic relationship between the department and all of its funding tools and airports really would benefit from a fresh review. A lot of the restrictions on airport financing really date from the pre-deregulation era and really would merit from an——

Senator FITZGERALD. What would examples of those restrictions be?

Ms. HECKER. Well, airports cannot discriminate between different categories, and it requires—for example, one of the most innovative proposals for better pricing of airspace was in Boston Logan Airport, and it was very creative and it was really dealing with the capacity issues and dealing with getting the right incentives in place for the use of the airspace. And FAA overruled it and said that it would discriminate against certain parties and was inconsistent with the authority of airports, and they didn't feel they even had the——

Senator FITZGERALD. How many airports have we built in those country in the last 20 years?

Ms. HECKER. One.

Senator FITZGERALD. One.

Senator HOLLINGS. Denver. I wonder, if you don't mind sharing your time with that roll call—I'd be willing to come back, but I'm afraid we're going to lose the panel—so these other senators who've been waiting.

Senator FITZGERALD. That's fine.

Senator HOLLINGS. Would that be all right? I'm with you. Richard Daley came here 10 years ago, and I was wrong—I didn't get enthused—but I'm enthused about it now.

[Laughter.]

Senator HOLLINGS. After you get a third airport. That's the only way to relieve that situation.

Senator FITZGERALD. But—one final thing—don't the airlines try to prevent the construction of a new airport in an area where they have a dominant hub? I mean, that's one of their ways of preventing competition that is—maybe we're not really looking at.

Ms. HECKER. Yes, they have that authority, and that's why a fresh look at the authorities and flexibilities of airports and developing the finance is really warranted.

Senator FITZGERALD. Thank you.

Senator HOLLINGS. Senator Carnahan.

STATEMENT OF HON. JEAN CARNAHAN,
U.S. SENATOR FROM MISSOURI

Senator CARNAHAN. Thank you, Mr. Chairman. Since I joined this Committee a few months ago, a great deal of attention has been given to the consolidation in the airline industry and the resulting impact on competition. We appear to be headed toward a situation where a few mega-carriers will dominate air travel in this country. Such consolidation would undoubtedly lead to higher fares, poor customer service, and fewer flights into small markets.

And while I support the main focus of S. 415, one aspect of it needs clarification. As I have stated previously, American Airline's proposed acquisition of substantially all of TWA's assets is distinctly different from the other aviation mergers that are currently pending.

Let's be clear. TWA can no longer function as an independent airline. The critical issue, therefore, is the future of the 20,000 TWA employees and their families. We are in need of a solution that protects these jobs and enables TWA retirees to continue receiving benefits.

American's proposal is the only solution that includes jobs for virtually all of TWA's contract employees and benefits for TWA's retirees. American's offer, therefore, is the best possible solution for TWA's employees, retirees, and the State of Missouri.

American's acquisition has been approved by the bankruptcy court. The review process is underway by the Department of Justice. Now is an extremely sensitive time for this transaction. It is critically important that nothing happens to prevent American's acquisition from being completed. I cannot overestimate the detrimental effect that any time delay would have on this process. Were it not for the financing provided by American, TWA would not even be operating today.

To ensure that the acquisition moves forward and that TWA's employees retain their job, the process must proceed in a timely

fashion. I'm confident that the intent of S. 415 is not to delay or to derail purchase of TWA's assets, and I am optimistic that the bill can be clarified to make this clear.

I look forward to working with the sponsors of the bill and the other members of the Committee to make this clarification so that we do not inadvertently create new obstacles to the approval of American's proposed acquisition of TWA's assets. Thank you, Mr. Chairman.

Senator HOLLINGS. Thank you very much.

Senator Edwards.

STATEMENT OF HON. JOHN EDWARDS,
U.S. SENATOR FROM NORTH CAROLINA

Senator EDWARDS. Thank you very much, Senator Hollings. Thank you very much for your work in this area. I share your concern and Senator McCain's concern about competition. I've talked about that at length with respect to the U.S. Air/United merger—or potential U.S. Air/United merger and its effect on my State of North Carolina.

Let me talk about a couple of things—or ask about a couple of things. With respect to the two major provisions of this bill, the second provision that requires DOT to do the 90-day study and gives them authority over requiring air carriers to make gates, facilities, and other assets available, that makes a great deal of sense to me, but I want to talk about the other major provision: giving DOT authority over mergers.

While I have—and have expressed great concern about competition and the impact these mergers could have on competition, I also, at the same time, have some concern about getting another government bureaucracy involved in the merger process and would just like to have comments from anybody on the panel who wants to comment about that. That's my concern. Why do we need to do it, and how do you balance that?

Mr. MILLER. Yeah, I think it's an obvious question and an obvious concern, but I think it's balanced by the expertise that DOT has in this industry and the need for them to play a more active role in competition, generally, coupled with the statement of Secretary Mineta's just recently, that he envisioned a greater role, even under the current law, for DOT.

So I think it's the expertise. I don't think there's any reason to think that DOT and DOJ wouldn't cooperate effectively here. And I think it's looking at the very, very large mergers. The——

Senator EDWARDS. Tom, doesn't DOT already consult with DOJ on these mergers?

Mr. MILLER. I think—clearly, they do, but this would give them a heightened role, and I think that that's one of the values, to make them more active, more involved in the competition issues.

And, you know, frankly, they've got this wealth of expertise on competition matters and on transportation and airline matters and have authority and relationships with the industry that DOJ does not have.

I clearly think DOJ's role should continue. They did a terrific job on the Continental/Northwest acquisition—or partial acquisition—

and stopped that. I think that they deserve a lot of credit for bringing the American Airlines case, as I discussed before.

So I don't think their role should be diminished, but I think a heightened, more active role of DOT would be a contribution, and an important one.

Dr. COOPER. We believe that there are two reasons that you have a second layer of policy review. Under the antitrust laws, sometimes what you get into a syndrome is where you're not allowed to look at the forest for the trees. So Justice goes merger by merger and does not—and under the statute, cannot—take a big-picture policy view of the overall industry and the direction you're going.

You get tangential arguments about merger waves and things like that. But the Department of Justice is not going to court to stop one merger because of the next one that will get triggered. It's a very difficult legal argument to make. So you need the big-picture policy review.

A second reason to do so, to look at—to have a second, sort of, policy review, is that some industries are different, and we worry about leaving it to only a merger-guidelines type of standard. We have this in the Communications Act, and we'll see some debate about that. The standard of antitrust in an industry such as this, which is moving toward a network basis which has a fairly low elasticity of demand, you ask yourself the question, "Is simple merger review sufficient to prevent the abuse of market power?"

And so for both of those reasons, a second layer of public-policy review, which is what this is about, I think, is extremely important. And an infrastructure industry—transportation and communications industries—have those characteristics that really do invite that broader policy review.

Mr. KAHAN. Just briefly, I think that the Department of Justice is really good at looking at some of the parts of the United/U.S. Air merger. For example, the idea that the two carriers have met, that they've decided to carve up the marketplace, that they have a scheme, that they have—that's traditional Department of Justice kind of stuff, and they're good at that. They ask for documents, they take depositions, so on and so forth.

In—S. 415, I believe, is correct because the barriers to entry in the airline business centering around airport access, gates, and slots is intertwined with DOT and FAA regulations and policy and creates a whole different set of concerns than you get in a typical merger situation in the general economy. And I think it could be justified that way very well.

Senator EDWARDS. Thank you for your comments. I think we have to go vote now.

Senator HOLLINGS. I want to thank, on behalf of the Committee, the panel. We'll keep the record open for questions, and we thank you very much. The Committee will be at ease subject to the call of the Chair.

[Whereupon at 11:14 a.m., the hearing was adjourned]

○